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**NEW SCHEME**

# Third Semester MBA Degree Examination, Dec.06 / Jan.07
## Business Administration
## Advanced Financial Management

Time: 3 hrs.] [Max. Marks:100

Note: *1. Answer any FIVE full questions including Q.No.8 which is compulsory.*
*2. Show working notes, wherever necessary.*

1 a. What are the features of trade credit as a short-term source of working capital finance? (03 Marks)

b. What are the basic strategies of efficient cash management? Illustrate with suitable examples the effect of these on the operating cash requirements of a firm. (07 Marks)

c. H Ltd has at present annual sales level of 10000 units at Rs.300 per unit. The variable cost is Rs.200 per unit and fixed cost amount to Rs.300000 per annum. The present credit period allowed by the company is 1 month. The company is considering a proposal to increase the credit period to 2 months and 3 months and has made the following estimates :

| | Existing | Proposed | |
|---|---|---|---|
| Credit period (month) | 1 | 2 | 3 |
| Increase in sales (per cent) | - | 15 | 30 |
| Bad debts (per cent) | 1 | 3 | 5 |

There will be increase in fixed cost by Rs.50000 on account of increase in sales beyond 25 per cent of present level. The company plans a pre-tax return of 20 per cent on investments in receivables.

You are required to calculate the most paying credit policy for the company. (10 Marks)

2 a. What purpose does the Baumol model of cash management serve? (03 Marks)

b. What are credit terms? Explain the significance of major components of credit terms in receivables management. (07 Marks)

c. The purchase department of an organization has received an offer of quantity discounts on its order of materials as under :

| Price per tonne | Tonnes |
|---|---|
| Rs.1400 | Less than 500 |
| Rs.1380 | 500 and less than 1000 |
| Rs.1360 | 1000 and less than 2000 |
| Rs.1340 | 2000 and less than 3000 |
| Rs.1320 | 3000 and above |

The annual requirement of material is 5000 tonnes. The delivery cost per order is Rs.1200 and the annual stock holding cost is estimated at 20 per cent of the average inventory.

The purchase department wants you to consider the following purchase options and advise which among them will be the most economical order quantity, presenting the information in a tabular form.

The purchase quantity options to be considered are : 400 tonnes, 500 tonnes, 1000 tonnes, 2000 tonnes and 3000 tonnes. (10 Marks)

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3 a. What are the objectives of receivables management? (03 Marks)

b. What is meant by the ABC inventory control system? On what key premise is this system based? What are its limitations? (07 Marks)

c. The following is the data regarding two companies X and Y belonging to the same risk class :

| Particulars | Company X | Company Y |
|---|---|---|
| Number of ordinary shares | 90000 | 150000 |
| Market price per share | Rs.1.20 | Rs.1.00 |
| 6% Debentures | Rs.60000 | - |
| Profit before interest | Rs.18000 | Rs.18000 |

All profits after debenture interest are distributed as dividends.
Explain how under Modigliani and Miller approach an investor holding 10 per cent of shares in Company X will be better off in switching his holdings to Company Y. (10 Marks)

4 a. How is inventory re-order point determined? (03 Marks)

b. Explain the factors that determine the capital structure of a firm. (07 Marks)

c. The earnings per share of a company is Rs.8 and the rate of capitalization applicable is 10 per cent. The company has before it, an option of adopting i) 50 ii) 75 and iii) 100 per cent dividend pay out ratio. Compute the market price of the company's quoted shares as per Walter's model, if it can earn a return of (A) 15, (B) 10 and (C) 5 per cent on its retained earnings. (10 Marks)

5 a. State the three basic assumptions of M-M approach to capital structure. (03 Marks)

b. Enumerate the legal, procedural and tax aspects relating to corporate dividend payments in India. (07 Marks)

c. A company has two divisions, A and B. Division A manufactures a component which is used by Division B to produce a finished product. For the next period, output and costs have been budgeted as follows :

| | Division A | Division B |
|---|---|---|
| Component units | 50000 | - |
| Finished units | - | 50000 |
| Total variable costs | Rs.250000 | 600000 |
| Fixed costs | Rs.150000 | 200000 |

The fixed costs are separable for each division. You are required to advise on the transfer price to be fixed for division A's component under the following circumstance :

i) Division A can sell the component in a competitive market for Rs.10 per unit. Division B can also purchase the component from the open market at that price.

ii) As per the situation described in i) above, and further assuming that Division B currently buys the component from an external supplier at the market price of Rs.10 and there is reciprocal agreement between the external supplier and another Division C, within the group. Under this agreement, the external supplier agrees to buy one product unit from Division C, at a profit of Rs.4 per unit to that division, for every component which Division B buys from the supplier. (10 Marks)

6 a. What do you understand by 'stock-split'? (03 Marks)

b. Explain the advantages and limitations of ROI and RI techniques of measuring divisional performance. (07 Marks)

c. Discuss the corporate governance conditions pertaining to the board of directors of listed companies (clause 49). (10 Marks)

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6 c. "The SEBI's decision to clause 49 in the listing agreement as per the recommendations of Kumara Mangalam Birla Committee goes a long way in bringing in better practices of corporate governance in the Indian Companies". Elucidate. (10 Marks)

7 a. Write a brief note on Baumol Model. (05 Marks)

b. "The value of a firm is independent of the proportion of debt to its total capitalization. The arbitrage process will establish a market equilibrium in which the total value of the firm will be depending only on investor's estimate of the firm's business risk, and its expected future income". Explain the above mentioned statement with the help of the following data regarding two companies. A and B with the same expected annual income and same risk class.

| Variables | Company A | Company B |
|---|---|---|
| Expected annual income (Y) | Rs.30000 | Rs.30000 |
| Market value of debt (L) | - | Rs.120000 |
| Rate of interest on debt (i) | - | 0.125 |
| Required rate of return on equity (K) | 0.15 | 0.16 |

Assume that the investor holds, 10% of the holding in the company with the maximum value. (15 Marks)

8 "Some thing is drastically wrong" exclaimed Mr. Subray Pai, the Finance Director of Zenith Corporation. He is absolutely unhappy with the way things are happening in the company's receivables management. The analysis of the past data indicates that the sales of the company can be improved further with minor changes in the Credit Policy of the company. The company. The company currently provides 40 days of credit to its customers. Its present level of sales is Rs.50 million. The firm's cost of capital is 10 per cent and the ratio of variable costs to sales is 0.85. The present credit terms of Company are 1 / 10, net 40. The proportion of sales on which customers currently take discount, $P_0$ is 0.5. Its cost of capital, k, is 10 per cent and tax rate is 30 per cent. He is now contemplating to increase the credit period or to change the discount terms. He is considering extending its credit period of 60 days. Such an extension is likely to push sales up by Rs.5 million. The bad debt proportion on additional sales would be 8 per cent. Alternatively he is considering relaxing its discount terms to 2 / 10, net 40. Such a relaxation is expected to increase sales by Rs.5 million, reduce the ACP to 20 days, and increase the proportion of discount sales to 0.8 with no bad debt losses. (Assume 360 days in a year)

You are required to

a. Identify and explain the dimensions of credit policy involved in the problem. (05 Marks)
b. Calculate the incremental income of the decision, extending the credit period. (05 Marks)
c. Calculate the incremental income of the decision, changing the credit terms. (05 Marks)
d. If he wishes to implement both and the incremental sales are likely to be 8 million and new ACP is going to be the same as of now, what will be the incremental income? (05 Marks)

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**Third Semester MBA Degree Examination, Dec. 07 / Jan. 08**

**Advanced Financial Management**

Time: 3 hrs. Max. Marks:100

**Note :** ***Answer any FOUR full questions from Q.No.1 to 7 and Q.No.8 is compulsory.***

1 a. State the relationship between ROI and ROE. (03 Marks)

b. Define the terms EVA (Economic Value Added) and MVA (Market Value Added). What is their utility in Financial Management? (07 Marks)

c. ABC Co. wishes to arrange overdraft facilities with its bankers during the period April to June 2007 when it will be manufacturing mostly for stock. Prepare a Cash Budget for the above period from the following data, indicating the extent of the bank facilities the company will require at the end of each month:

| Month | Sales (Rs.) | Purchases (Rs.) | Wages (Rs.) |
|---|---|---|---|
| February | 180000 | 124800 | 12000 |
| March | 192000 | 144000 | 14000 |
| April | 108000 | 243000 | 11000 |
| May | 174000 | 246000 | 10000 |
| June | 126000 | 268000 | 15000 |

50 per cent of the credit sales are realized in the month following the sales and the remaining 50 per cent in the second month following. Creditors are paid in the month of purchase.

Cash at Bank on 1.4.2007 (estimated) Rs.25000 (10 Marks)

2 a. What is the Annual percentage interest cost associated with the credit term 2/10 net 45? (03 Marks)

b. Briefly explain the legal aspects of dividends paid by a Company? (07 Marks)

c. Alfa Ltd. with net operating earnings of Rs.300000 is attempting to evaluate a number of possible capital structures, given below. Which of the capital structure will you recommend and why?

| Capital Structure | Debt in capital structure Rs. | Cost of debt ($K_i$)(per cent) | Cost of equity ($K_e$)(per cent) |
|---|---|---|---|
| 1 | 300000 | 10 | 12 |
| 2 | 400000 | 10 | 12.5 |
| 3 | 500000 | 11 | 13.5 |
| 4 | 600000 | 12 | 15 |
| 5 | 700000 | 14 | 18 |

(10 Marks)

3 a. What is ABC analysis in inventory management? (03 Marks)

b. Following is the information relating to ABC Limited and XYZ Limited:

| Rs. in million | | |
|---|---|---|
| Description | ABC limited | XYZ limited |
| Current Assets (CA) | Rs.200 | Rs.80 |
| Net fixed Assets (FA) | Rs.80 | Rs.200 |
| Total Assests (TA) | Rs.280 | Rs.280 |
| Earnings Before Interest and Taxes (EBIT) | Rs.700 | Rs.700 |
| ROI | 25% | 25% |

You are required to compute the working capital leverage, with a 20% increase / reduction in current assets. (07 Marks)

3 c. C.S.Ltd. has 8 lakhs equity shares outstanding at the beginning of the year 2007. The current market price per share is Rs.120. The Board of Directors of the company is contemplating Rs.6.4 per share as dividend. The rate of capitalization, appropriate to the risk – class to which the company belongs, is 9.6%.

i) Based on M-M Approach, calculate the market price of the share of the company, when the dividend is –
   ⇒ declared; and
   ⇒ not declared.

ii) How many new shares are to be issued by the company, if the company desires to fund an investment budget of Rs.3.20 crores by the end of the year assuming net income for the year will be Rs.1.60 crores? (10 Marks)

4 a. What are the costs of receivables? (03 Marks)

b. Explain the Miller – Orr model of optimum Cash Balance. From the following information determine the optimum cash balance, optimum return point and optimum upper limit for the organization:
   Lower limit – 200000
   Transaction cost – Rs.1600
   Standard deviation – Rs.5000
   Interest rate per annum – 12%
   No. of days in a year – 360 (07 Marks)

c. What is Divisionalisation? Explain the advantages of Divisionalisation. How is the divisional performance measured? (10 Marks)

5 a. What are the sources from which a company can issue Bonus Shares? (03 Marks)

b. Two components A and B are used as follows:
   Normal usage : 50 units each per week
   Minimum usage : 25 units each per week
   Maximum usage : 75 units each per week
   Re-order quantity : A – 300 units, B – 500 units
   Re-order period: A – 4 to 6 weeks, B – 2 to 4 weeks
   Calculate the following for each component:
   i) Re-order level, ii) Minimum level, iii) Maximum level and iv) Average stock level. (07 Marks)

c. What are the various modes in which banks provide financing for the working capital requirements of the company? Explain the recommendations of Tandon Committee for Maximum Permissible Bank Finance in brief. (10 Marks)

6 a. What do you mean by the term working capital? What are its types? (03 Marks)

b. XYZ Ltd. is considering three financial plans for which the key information is as below:
   i) Total investment to be raised Rs.400000
   ii) Plans of financing proportion:

| Plans | Equity | Debt | Preference Shares |
|---|---|---|---|
| A | 100% | Nil | Nil |
| B | 50% | 50% | Nil |
| C | 50% | Nil | 50% |

   iii) Cost of Debt 8%, Cost of preference shares 8%.
   iv) Tax Rate 50%
   v) Equity shares of the face value of Rs.10 each will be issued at a premium of Rs.10 per share.
   vi) Expected EBIT is Rs.160000

   Determine for each plan:
   i) Earnings per share (EPS).
   ii) Financial break – even point. (07 Marks)

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# Third Semester MBA Degree Examination, Dec.08/Jan.09
## Advanced Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1.*Answer any FOUR questions from Q.1 to Q.7. Question No.8 is compulsory.*
2. *Show working notes wherever necessary.*

1 a. What are the disadvantages of issuing Bonus shares? **(03 Marks)**
b. What are the various factors should be considered for efficient cash-management? **(07 Marks)**
c. A firm has current sales of Rs.7,20,000. It is considering offering the credit terms '2/10 net 30' instead of 'Net 30'. It is expected that sales will increase by Rs.20,000 and the average collection period will reduce from 30 days to 20 days. It is also expected that 50% of the customers will take discounts and pay on 10th day and remaining 50% will pay on 30th day. Bad debt losses will remain at 2% of sales. The firms variable cost ratio is 70%, corporate tax rate is 50% and opportunity cost of investment in receivables is 10%. Should the company change its credit terms? **(10 Marks)**

2 a. What are the three important components required to determine the optimum cash level under certainty? **(03 Marks)**
b. What is factoring? What functions does it perform? **(07 Marks)**
c. Find the optimal order quantity for a product where the annual demand for the product is 500 units. The cost of storage per unit per year is 10% of the unit cost and ordering cost per order is Rs. 180. The unit costs are given below.

| Quantity | Unit cost (Rs.) |
|---|---|
| $0 \leq Q_1 < 500$ | 25.00 |
| $500 \leq Q_2 < 1500$ | 24.80 |
| $1500 \leq Q_3 < 3000$ | 24.60 |
| $3000 \leq Q_4$ | 24.40 |

**(10 Marks)**

3 a. What are the various cost associated with maintaining receivables? **(03 Marks)**
b. What is ABC analysis? Explain the steps involved in controlling the investment in inventories. **(07 Marks)**
c. Regal Sports Equipment Ltd., is trying to determine its optimal capital structure. The company's capital structure consists of debt and common stock. In order to estimate the cost of debt, the company has produced the following table.

| Financed with Debt (%) | 10 | 20 | 30 | 40 | 50 |
|---|---|---|---|---|---|
| Before tax cost of debt(%) | 7.0 | 7.2 | 8.0 | 8.8 | 9.6 |

The company's tax rate is 40%. The company uses the CAPM to estimate its cost of common stock. The risk free rate is 5% and the market risk premium is 6%. Regal estimates that if it had no debt its beta would be 1.0 (unlevered beta). Based on this information, what is the company's optimal capital structure and what is the firm's cost of capital at this optimal capital structure? **(10 Marks)**

4 a. Why do organizations have precautionary and speculative motive in holding inventories? **(03 Marks)**
b. What is net income approach? How does it differ from NOI approach? **(07 Marks)**
c. Malaika Steels has 1 lakh equity shares, which are selling at Rs. 100 each. Its capitalization rate is 14%. The firm is expecting Rs.65 lakhs income for the current year and is planning to pay dividends amounting to Rs. 4 lakhs. The company wants to invest in a new project which will cost Rs.75 lakhs. It is assumed that M-M model of dividend policy applicable to the company.

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(i) Compute the price/share at the end of the current year and the no. of shares to be issued for financing the investment when dividends amounting to Rs. 4 lakhs are paid.

(ii) Compute the price/share at the end of the current year and the no. of shares to be issued for financing the investment when dividends are not paid. **(10 Marks)**

5 a. What are the various sources available to finance the current assets? **(03 Marks)**

b. What are the advantages to an organization that has stable dividend policy? **(07 Marks)**

c. What do you understand by transfer prices? Enumerate the various methods of transfer pricing. **(10 Marks)**

6 a. What do you mean by Agency costs? **(03 Marks)**

b. What do you understand by market value added and economic value added? **(07 Marks)**

c. What are the various signals of firm's sickness? What are the problems in rehabilitation of sick units? **(10 Marks)**

7 a. When does managerial entrenchment occur? What are the non-pecuniary benefits that the

b. entrenched managers enjoy? **(05 Marks)**

From the information and the assumption that the cash balance in hand on 1st December, 2008 is Rs.72,500. Prepare a cash budget.

Assume that 50% of total sales are cash sales. Assets are to acquired in the months of January and March. Therefore, provisions should be made for the payment of Rs.8000 and Rs. 25000 for the same. An application has been made to the bank for the grant of a loan of Rs. 30000 and it is hoped that the loan amount will be received in the month of April.

It is anticipated that a dividend of Rs. 35000 will be paid in May. Debtors are allowed one month's credit. Creditors for materials purchased and overheads grant one months credit. Sales commission at 3% on sales is paid to the salesman each month. **(15 Marks)**

| Month & Year | Sales (Rs.) | Materials Purchased Rs.) | Salaries wages (Rs.) | Production overheads (Rs.) | Office & selling overheads (Rs.) |
|---|---|---|---|---|---|
| Dec'08 | 72,000 | 25,000 | 10,000 | 6,000 | 5,500 |
| Jan'09 | 97,000 | 31,000 | 12,100 | 6,300 | 6,700 |
| Feb'09 | 86,000 | 25,500 | 10,600 | 6,000 | 7,500 |
| Mar'09 | 88,600 | 30,600 | 25,000 | 6,500 | 8,900 |
| Apr'09 | 1,02,500 | 37,000 | 22,000 | 8,000 | 11,000 |
| May'09 | 1,08,700 | 38,800 | 23,000 | 8,200 | 11,500 |

8 Anil automobiles operates in the auto spares industry. The income statement of the company is as follows:

| Particulars | Sales | Cost of sales | Net operating income | Interest | Earnings to equity share holders |
|---|---|---|---|---|---|
| Rs.in lakhs | 500 | 300 | 200 | 60 | 140 |

The capitalization rate for debt is 10% and capitalization rate for entire firm is 12.5%. Assume that the Net operating income approach to capital structure is applicable.

a. What is the market value of debt of the firm? **(02 Marks)**

b. What is the total market value of the firm? **(02 Marks)**

c. What is the market value of the equity of the firm? **(02 Marks)**

d. What is the equity capitalization rate? What impact does the equity capitalization rate have if debt content increases under NOI approach? **(03 Marks)**

e. If other things remain the same then, what is the maximum amount of funds that the firm can borrow in terms of market value so that its equity capitalization rate does not exceed 16%? **(08 Marks)**

f. Does Anil automobiles have optimal capital structure? **(03 Marks)**

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7 a. What are the major problems faced in rehabilitation of sick units? What are the important steps to be taken for preparing an effective nursing programme for rehabilitating a sick unit?

b. Prepare cash budget for January-June from the following information :

i) The estimated sales and expenses are as follows :

| Particulars | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | Jun. |
|---|---|---|---|---|---|---|---|---|
| Sales (Rs.) | 200000 | 220000 | 120000 | 100000 | 150000 | 240000 | 200000 | 200000 |
| Wages & Salaries | 30000 | 30000 | 24000 | 24000 | 24000 | 30000 | 27000 | 27000 |
| Misc. Expenses (Rs.) | 27000 | 27000 | 21000 | 30000 | 24000 | 27000 | 27000 | 27000 |

ii) 20 per cent of the sales are on cash and balance on credit.

iii) The firm has a gross margin of 25 per cent on sales.

iv) 50 per cent of the credit sales are collected in the month following the sales, 30 per cent in the second month and 20 per cent in the third month.

v) Material for the sale of each month is purchased one month in advance, on a credit for two months.

vi) The time-lag in the payment of wages and salaries is one-third of a month and of miscellaneous expenses, one month.

vii) Debentures worth Rs.40000 were sold in January.

viii) The firm maintains a minimum cash balance of Rs.40000. Funds can be borrowed @ 12 per cent per annum in the multiples of Rs.1000, the interest being payable on monthly basis.

ix) Cash balance at the end of December is Rs.60000.

Show working notes wherever necessary. (15 Marks)

8 Company X and Company Y are in the same risk class, and are identical in every respect, except that company X uses debt, while company Y does not. The levered firm has Rs.900000 debentures, carrying 10 per cent rate of interest. Both the firms earn 20 per cent operating profit on their total assets of Rs.15 lakh. Assume perfect capital markets, rational investors and so on : a tax rate of 35 per cent and capitalization rate of 15 per cent for an all equity company.

a. Compute the value of firms X and Y, using Net Income (NI) approach. (05 Marks)

b. Compute the value of each firm, using Net Operating Income (NOI) approach. (05 Marks)

c. Using the NOI approach, calculate the overall cost of capital ($k_o$) for firms X and Y. (07 Marks)

d. Which of these two firms has an optimal capital structure according to the NOI approach? Why? (03 Marks)

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# Third Semester MBA Degree Examination, June-July 2009
## Advanced Financial Management

Time: 3 hrs. Max. Marks:100

**Note : *1. Answer any FIVE full questions, including Q.No.8, which is compulsory.***
***2. Give working notes wherever necessary.***

1 a. What are the three basic approaches to determine an appropriate financing mix in working capital management? **(03 Marks)**
b. Outline Walter's model of Dividend Relevance. **(07 Marks)**
c. Sagar company currently makes all sales on credit and offers no cash discount. It is considering a 2 percent discount for payment within 10 days. The firm's current average collection period is 60 days, sales are 2,00,000 units, selling price is Rs. 30 per unit, variable cost per unit is Rs 20 and average cost per unit is Rs. 25 at the current sales volume. It is expected that the change in credit terms will result in increase in sales to 2,25,000 units and the average collection period will fall to 45 days. However, due to increased sales, increased working capital required will be Rs. 1,00,000 (it does not take into account the effect on debtors). Assuming that 50 percent of the total sales will be on cash discount and 20 percent is the required return on investment, should the proposed discount be offered? **(10 Marks)**

2 a. What are the basic strategies of efficient cash management? **(03 Marks)**
b. Explain the objectives of receivables management, highlighting the relevant costs and benefits. **(07 Marks)**
c. PQR Tubes Ltd are the manufacturers of picture tubes for T.V. The following are the details of their operations during current financial year.

| | |
|---|---|
| Ordering cost (per order) | Rs. 100 |
| Inventory carrying cost (per annum) | 20 % |
| Cost of tubes (per tube) | Rs . 500 |
| Normal usage (tubes per week) | 100 |
| Minimum usage (tubes per week) | 50 |
| Maximum usage (tubes per week) | 200 |
| Lead time to supply (weeks) | 6 - 8 |

Required :
i) Economic order quantity. If the supplier is willing to supply quarterly 1,500 units at a discount of 5 percent, is it worth accepting? ii) Re-order level.
iii) Maximum level of stock iv) Minimum level of stock. **(10 Marks)**

3 a. What does EBIT – EPS Analysis involve? **(03 Marks)**
b. Describe any three prominent marketable / near – cash securities available for investment of surplus cash. **(07 Marks)**
c. The following information is available in respect of the rate of return on investment (r), the capitalization rate ($K_e$) and earnings per share (E) of Hypothetical Ltd.
r = 12 percent E = Rs 20.

Determine the value of its share, as per Gordon's Model of Dividend Relevance, assuming the following : **(10 Marks)**

| | D/P ratio (1 – b) | Retention ratio (b) | $K_e$ (%) |
|---|---|---|---|
| 1 | 10 | 90 | 20 |
| 2 | 20 | 80 | 19 |
| 3 | 30 | 70 | 18 |
| 4 | 40 | 60 | 17 |
| 4 | 50 | 50 | 16 |
| 6 | 60 | 40 | 15 |
| 7 | 70 | 30 | 14 |

4 a. What do – ROI and ROE – measure and how are they computed? **(03 Marks)**

b. Explain the meaning, methodology and advantages of ABC Analysis of Inventory control. **(07 Marks)**

c. The following is the data regarding two companies 'A' and 'B' with the same expected annual income and belonging to same risk class :

| Variables | Company A | Company B |
|---|---|---|
| Expected annual income (Y) | Rs. 30,000 | Rs. 30,000 |
| Market value of debt (L) | - | 1,20,000 |
| Rate of interest on debt (i) | - | 0.125 |
| Required rate of return on equity (K) | 0.15 | 0.16 |
| Market value of equity (E) | 2,00,000 | 93,750 |
| Market value of company (V), Where V = L + E | 2,00,000 | 2,13,750 |

Explain how under Modigliani and Miller Approach an investor holding 10 percent of shares in Company B will be better off in switching his holdings to Company A. **(10 Marks)**

5 a. What are the five C's determining a firm's credit standards? **(03 Marks)**

b. Explain the Net Operating Income (NOI) Approach to capital structure of a firm. **(07 Marks)**

c. Discuss i) Commercial papers and ii) Factoring –as sources of working capital finance. **(10 Marks)**

6 a. What is meant by Dividend Stability? What are the different forms the stability of dividend can take? **(03 Marks)**

b. Distinguish between : i) Gross working capital and Net working capital ii) Permanent and Temporary working capital and iii) Production cycle and Operating cycle. **(07 Marks)**

c. A company manufactures a product from a raw material, which is purchased at Rs. 60 per kg. The company incurs a handling cost of Rs. 360 plus freight of Rs. 390 per order. The incremental carrying cost of inventory of raw material is Re. 0.50 per kg per month. In addition, the cost of working capital finance on the investment in inventory of raw material is Rs. 9 per kg per annum. The annual production of the product is 1,00,000 units and 2.5 units are obtained from one kg of raw material.

Required : i) Calculate the economic order quantity of raw materials.

ii) Advise, how frequently should orders for procurement be placed.

iii) If the company proposes to rationalize placement of orders on quarterly basis, what percentage of discounts in the price of raw materials should be negotiated? **(10 Marks)**

7 a. What is the Agency Problem? How do market forces and agency costs act to prevent / minimize this problem? **(05 Marks)**

b. Easy Limited specializes in the manufacture of a computer component. The component is currently sold for Rs. 1,000 and its variable cost is Rs. 800. For the current year ended March 31, the company sold on an average 400 components per month. At present, the company grants one month's credit to its customers. It is thinking of extending the same to two months on account of which the following are expected :
Increase in Sales – 25 percent ; Increase in Stock – Rs. 2,00,000 ;
Increase in Creditors – Rs. 1,00,000
You are required to advise the company on whether or not to extend credit terms if
i) all customers avail of the extended credit period of two months and
ii) existing customers do not avail of the credit terms but only the new customers avail of the same.
Assume the entire increase in sales is attributable to the new customers. The company expects a minimum return of 40 percent on the investments. **(15 Marks)**

8 **CASE STUDY (Compulsory)**

Prepare a cash budget for the 6 months ending 31st December 2008, from the monthly budgeted operating results of company and other additional information given below.

(Rs. Lakh)

| | Sales | Purchases | Wages | Overheads | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Production | Administration | Selling | Distribution | R & D |
| March | 8.00 | 3.60 | 0.80 | 0.48 | 0.40 | 0.20 | 0.10 | 0.11 |
| April | 12.00 | 6.00 | 1.28 | 0.64 | 0.56 | 0.29 | 0.14 | 0.16 |
| May | 9.60 | 5.20 | 1.20 | 0.62 | 0.48 | 0.25 | 0.10 | 0.12 |
| June | 6.40 | 3.36 | 0.56 | 0.30 | 0.20 | 0.11 | 0.06 | 0.06 |
| July | 8.00 | 3.84 | 0.80 | 0.44 | 0.32 | 0.16 | 0.08 | 0.10 |
| Aug | 8.80 | 4.00 | 0.96 | 0.49 | 0.40 | 0.21 | 0.10 | 0.12 |
| Sept | 11.20 | 4.96 | 1.20 | 0.62 | 0.52 | 0.26 | 0.12 | 0.13 |
| Oct | 12.80 | 6.00 | 1.04 | 0.54 | 0.40 | 0.20 | 0.10 | 0.12 |
| Nov | 14.40 | 6.40 | 1.36 | 0.72 | 0.56 | 0.29 | 0.15 | 0.16 |
| Dec | 16.00 | 8.00 | 1.52 | 0.74 | 0.58 | 0.30 | 0.16 | 0.17 |

a. New machinery which is to be installed in April at a cost of Rs.1.20 lakh is to be paid for on 1st August. Extension to the R and D block amounting to Rs. 8.00 lakh in total is contemplated from September at the rate of Rs.1.60 lakh per month. Rs 2.40 lakh per month is to be paid under a hire purchase scheme.
b. The sales commission of 4 percent on sales not included in selling overheads is to be paid within the month following actual sales.
c. The period of credit allowed by suppliers is 4 months, and that allowed to customers is 3 months. The delay in the payment of overheads is 2 months and that in payment of wages is one – fourth of a month.
d. Preference share dividend of 8 percent on the capital of Rs. 160.00 lakh is payable on 1st December. 8 percent calls on equity shares at the rate of Rs. 9.60 lakh is due on 1st July, 1st September and 1st November.
e. Taxation of Rs.8.00 lakh is payable on 1st November.
f. Dividends on investment amounting to Rs.2.40 lakh are expected on 1st July and 1st December.
g. Cash sales of Rs. 0.80 lakh per month are expected on which no commission is payable. This 'cash sales' is not included in the details for sales given in the Table above.
h. Cash balance on 1st July 2008 was expected to be Rs. 2.00 lakh. **(20 Marks)**

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08MBAFM321

# Third Semester MBA Degree Examination, Dec.09/Jan.10
# Advanced Financial Management

Time: 3 hrs. Max. Marks:100

**Note:** ***1. Answer any FOUR full questions from the Q.No.1 to 7.***
***2. Question No. 8 is compulsory.***



1 a. What is the goal of working capital management? **(03 Marks)**

b. Following information is given of X Ltd. (Rs. Lakhs)

| | |
|---|---|
| Fixed assets | 300 |
| Current assets | 200 |
| Total assets | 500 |

c. The entire current assets are being financed by the bank finance at 16% p.a. The earnings before tax (EBT) of the company is Rs.100 lakhs. The company is planning to reduce its level of investment in current assets by Rs.100 lakhs with an efficient working capital management. Show the impact of change in working capital on the company's return on investment (ROI). **(07 Marks)**

Write a detailed note on Baumol's EOQ model of cash management along with the assumptions involved. What are the limitations of this model? **(10 Marks)**

2 a. What are the assumptions in calculating EOQ in inventory management? **(03 Marks)**

b. A firm has credit sales amounting to Rs.32,00,000. The sales price per unit is Rs.40, the variable cost is Rs.25 per unit while the average cost per unit is Rs.32. The average age of accounts receivables of the firm is 72 days. The firm is planning to tighten credit standards. It will result in a fall in the sales volume to Rs.28,00,000 and the average age of accounts receivable to 45 days. Assume a 20 percent rate of return. Is the proposal under consideration feasible? **(07 Marks)**

c. Economic Enterprises require 90,000 units of certain items annually. The cost per unit is Rs.3. the cost per purchase order is Rs.300 and the inventory carrying cost is Rs.6 per unit per year.

i) What is the EOQ?

ii) What should the firm do if the suppliers offer discount as detailed below:

| Order quantity | Discount |
|---|---|
| 4,500 – 5999 | 2 percent |
| 6,000 and above | 3 percent |

**(10 Marks)**

3 a. What are the objectives of receivables management? **(03 Marks)**

b. What are credit terms? Explain each of the credit terms and the significance of major components of credit terms in receivables management? **(07 Marks)**

c. The Asbestos company belongs to a risk class of which the appropriate capitalization rate is 10 percent. It currently has 1,00,000 shares selling at Rs.100 each. The firm is contemplating the declaration of a Rs.6 dividend at the end of the current fiscal year, which has just began. Answer the following questions based on Modigliani and Miller model and the assumptions of no taxes.

i) What will be the price of the shares at the end of the year, if a dividend is not declared? What will it be if it is declared?

ii) Assuming that the firm pays dividend, has a net income of Rs.10,00,000 and makes new investment of Rs.20,00,000 during the period, how many new shares must be issued? **(10 Marks)**

4 a. What do you mean by stock split? **(03 Marks)**

b. From the following information supplied to you, determine the theoretical market value of equity shares of a company as per Walter's model.

| | |
|---|---|
| Earnings of the company | Rs.5,00,000 |
| Dividends paid | Rs.3,00,000 |
| Number of shares outstanding | 1,00,000 |
| Price earnings ratio | 8 |
| Rate of return on investment | 0.15 |

Are you satisfied with the current dividend policy of the firm? If not, what should be the optimal dividend pay out ratio in this case? **(07 Marks)**

c. Discuss the internal and external devices for containing agency costs. **(10 Marks)**

5 a. Differentiate between explicit cost and implicit cost in relation to cost of debt. **(03 Marks)**

b. The following is the data regarding two companies "X" and "Y" belonging to the same risk class.

| Particulars | Company X | Company Y |
|---|---|---|
| Number of ordinary shares | 90,000 | 1,50,000 |
| Market price per share | Rs.1.20 | Rs.1.00 |
| 6% debentures | 60,000 | - |
| Profit before interest | 18,000 | 18,000 |

All profits after debentures interest are distributed as dividends. Explain how under Modigline and Miller approach an investor holdings 10 percent of shares in company X will be better off in switching his holding to company Y. **(07 Marks)**

c. What are the essential differences between Angel Investors and Venture Capital Providers? **(10 Marks)**

6 a. What are corporate financial models? What are their users? **(03 Marks)**

b. Enumerate in detail the symptoms of industrial sickness. **(07 Marks)**

c. Explain in detail the concept of economic value added (EVA). What are the merits of EVA? How can EVA be improved? **(10 Marks)**

7 a. Write a short note on optimum level of current assets. **(05 Marks)**

b. The following data pertains to a shop. The owner has made the following sales forecasts for the first 5 months of the coming year.

| | | | | | |
|---|---|---|---|---|---|
| January | Rs.40,000 | March | 55,000 | May | 50,000 |
| February | Rs.45,000 | April | 60,000 | | |

Other data are as follows:

i) Debtors and creditors balances at the beginning of the year are Rs.30,000 and Rs.14,000, respectively. The balances of other relevant assets and liabilities are :

| | |
|---|---|
| Cash balance | Rs.7500 |
| Stock | Rs.51,000 |
| Accrued sales commission | Rs.3,500 |

ii) 40 percent sales are on cash basis. Credit sales are collected in the month following the sale.

iii) Cost of sales is 60 percent of sales

iv) The only other variable cost is a 5 percent commission to sales agents. The sales commission is paid in the month after it is earned.

v) Inventory (stock) is kept at equal to sales requirements for the next two months' budgeted sales.

vi) Trade creditors are paid in the following month after purchases.

vii) Fixed costs are Rs.5,000 per month, including Rs.2,000 depreciation.

You are required to prepare a cash budget for each of the first three months of coming year. **(15 Marks)**

8 ***<u>Case study:</u>***

A company's current operating income is Rs.4 lakhs. The firm has Rs.10 lakh of 10 percent debt outstanding. Its cost of equity capital is estimated to be 15 percent.

a. Determine the current value of the firm using traditional valuation approach.

b. Calculate:

i) The overall capitalization rate as well as both types of leverage ratios.

ii) Debt/equity (B/S)

iii) Debt/value (B/V)

c. The firm is considering increasing its leverage by raising an additional Rs.5,00,000 debt and using the proceeds to return that amount of equity. As a result of increased financial risk, $K_i$ is likely to go up to 12 percent and $K_e$ to 18 percent. Could you recommend the plan? **(20 Marks)**

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