

University of Mumbai

Program: ALL_Institute Level Optional Course 2

Question Bank

Curriculum Scheme: Rev2016

Examination: BE Semester VIII

Course Code: ILO 8022 and Course Name: Finance Management

Subjective Questions

1	PNG's current assets and current liabilities are ₹2,00,00,000 and ₹1,40,00,000 respectively. How much additional funds can it borrow from banks for short term, without reducing the current ratio below 1.33?
2	Distinguish between equity & debt instruments.

Debt Capital	Equity Capital
Definition	
Debt Capital is the borrowing of funds from individuals and organisations for a fixed tenure.	Equity capital is the funds raised by the company in exchange for ownership rights for the investors.
Role	
Debt Capital is a liability for the company that they have to pay back within a fixed tenure.	Equity Capital is an asset for the company that they show in the books as the entity's funds.
Duration	
Debt Capital is a short term loan for the organisation.	Equity Capital is a relatively longer-term fund for the company.
Status of the Lender	
A debt financier is a creditor for the organisation.	A shareholder is the owner of the company.
Types	
Debt Capital is of three types: <ul style="list-style-type: none"> • Term Loans • Debentures • Bonds 	Equity Capital is of two types: <ul style="list-style-type: none"> • Equity Shares • Preference Shares
Risk of the Investor	
Debt Capital is a low-risk investment	Equity Capital is a high-risk investment
Payoff	
The lender of Debt Capital gets interest income along with the principal amount.	Shareholders get dividends/profits on their shares.
Security	
Debt Capital is either secured (against the surety of an asset) or unsecured.	Equity Capital is unsecured since the shareholders get ownership rights.

3	What are leverage ratios? Explain any two types of the same.
4	How and why are risk and return considered significant factors in finance management?
	What is mezzanine financing? Explain with an example.
5	<p style="text-align: center;">FINANCIAL MANAGEMENT (Sources of Finance)....Page no. (5-7)</p> <h3 style="text-align: center;">5.3 MEZZANINE FINANCE</h3> <ul style="list-style-type: none"> - Mezzanine financing is a cross breed of obligation and value financing that gives the loan specialist the option to change over to a value interest in the organization if there should be an occurrence of default, by and large, after investment organizations and other senior moneylenders are paid. - Mezzanine debt has inserted value instruments appended, frequently known as warrants, which increment the estimation of the subjected obligation and permit more noteworthy adaptability when managing bondholders. - Mezzanine financing is often connected with acquisitions and buyouts, for which it very well might be utilized to focus on new proprietors in front of existing proprietors if there should be an occurrence of case of bankruptcy. - Mezzanine loans are subordinate to senior debt but have priority over both preferred and common stock. - They carry higher yields than ordinary debt. - They are often unsecured debts. - There is no amortization of loan principal. <p>It may be structured as part fixed and part variable interest.</p> <p>The diagram is titled 'MEZZANINE FUND' at the top. It includes several sections: 'CHARACTERISTICS' (listing features like being subordinate to senior debt, having higher yields, and no principal amortization), 'BENEFITS' (listing advantages for borrowers and lenders), and 'RATE OF RETURN' (listing factors like high rates of interest and various return options). A central box states: 'Mezzanine Fund or Mezzanine loan does not fall into the category of a pure debt or pure equity. In other words, it is very high risk and high reward instrument that fills the gap between senior debt and equity.'</p>

Fig. 5.3.1 ; Mezzanine Finance

5.3.1 Advantages and Disadvantage Mezzanine Financing

 **GQ:** Explain with an advantage and disadvantage Mezzanine Financing.

Advantages of Mezzanine Financing

1. Mezzanine financing may bring about banks—or financial backers—acquiring value in a business or warrants for buying value sometime in the future.
2. This may altogether expand a financial backer's pace of return (ROR). Moreover, mezzanine financing suppliers get authoritatively committed interest installments month to month, quarterly, or yearly.
3. Borrowers favor mezzanine obligation on the grounds that the interest is charge deductible. Additionally, mezzanine financing is more reasonable than other obligation structures since borrowers may calculate their advantage yet to be determined of the advance.
4. On the off chance that a borrower can't make a planned interest installment, a few or the entirety of the interest might be conceded. This choice is regularly inaccessible for different sorts of obligation.
5. Likewise, rapidly extending organizations fill in esteem and rebuild mezzanine financing into one senior advance at a lower loan fee, saving money on premium expenses in the long haul.

Disadvantages of Mezzanine Financing

1. Nonetheless, while getting mezzanine financing, proprietors penance control and potential gain potential because of the deficiency of value. Proprietors likewise pay more in interest the more drawn out mezzanine financing is set up.
2. For mezzanine loan specialists, they're in danger of losing their interest in case of chapter 11. At the end of the day, when an organization leaves business, the senior obligation holders get paid first by exchanging the organization's resources.
3. On the off chance that there are no resources staying after the senior obligation gets paid off, mezzanine loan specialists miss out.

5.3.2 Example of Mezzanine Financing

- For instance, Bank XYZ gives Company ABC, a creator of careful gadgets, with \$15 million in mezzanine financing. The financing supplanted a higher interest \$10 million acknowledge line for more great terms.
- Organization ABC acquired working funding to help carry extra items to the market and took care of a higher premium obligation. Bank XYZ will gather 10% every year in revenue installments and will actually want to change over to a value stake if the organization defaults.

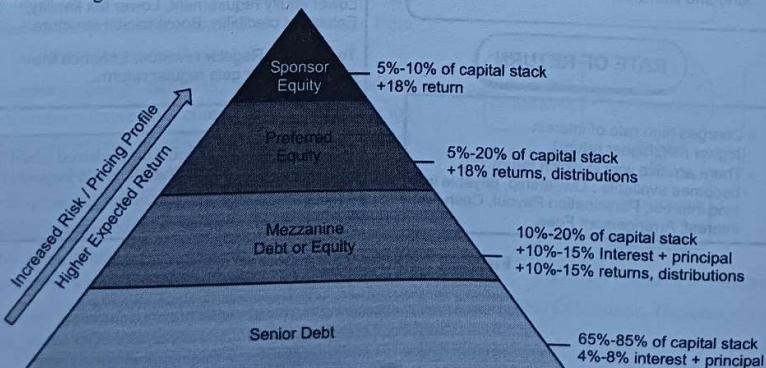


Fig. 5.3.2 : Mezzanine Financing

6	Describe in brief the Net income Approach as a Capital Structure theory.
7	Explain various Financial Instruments in detail

► 1.2 FINANCIAL INSTRUMENTS

↳ 1.2.1 Capital Markets Instruments

GQ. What are Capital Markets Instruments ? Explain types of Capital Markets.

- Capital market are wherever savers invent to capitalize their capital in extended period investments such as business debt, justness funded securities, and government bonds.
- In further words, investors those by means of capital come to benefit from and those who necessary capital originate to borrow.
- So businesses create to the capital marketplaces in demand to borrow money to asset a new communications project they are enterprise these are recognized as corporate bonds.

Key Points

1. Resources markets are where investor come to loan to borrowers.
2. Capital markets submit to long term issue of debt, which difference to money markets that cover short term debts.
3. The two highest types of capital marketplaces are primary and secondary. The primary market is wherever new debt and equity is issue whilst the secondary marketplace is where old debt and equities are traded between investor.

Two Types of Capital Markets

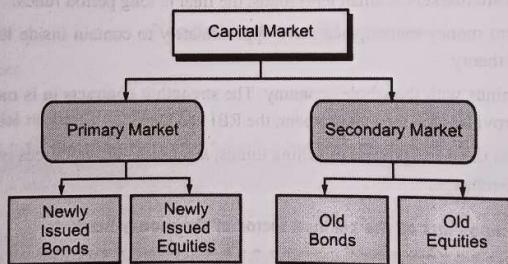


Fig 1.2.1 : Capital Market

↳ Primary Market

- The primary capital market is anywhere new debt / stocks stay issue. This strength come in the formula of government bonds, or, on the additional hand, shares in a company.
- If not known as the **New Issues Market** it is where business and government come to find new money.
- Otherwise known as the **New Issues Market**, the main market is wherever new debit and equities are sold.

↳ Secondary Markets

- The secondary wealth market is wherever new debt or stocks are trade amongst investors.
- This difference with the primary marketplace as the debit has previously been issued. In real meaning, the debt is substitute as real money.
- The secondary capital marketplace is wherever old debt or stocks remain trade between investors.

- Investor uses the secondary market in order to acquire cash perhaps to invest in another stock or for confidential utilization. In financial terms, it is simply to settle resources so other things can be bought.
- The bond marketplace is very various with thousands and millions of issuers across the world. Each has a dissimilar yield, maturity, and qualities. It is for this motive that the secondary market sells bonds primarily 'Over the Counter' (O T C).

8	Suppose you deposit \$1,000 in an account that pays 12% interest, <u>compounded quarterly</u> . How much will be in the account after eight years if there are no withdrawals? Explain concept of Annuity in detail
9	Explain various Techniques of inventory Management

► 4.8 MANAGEMENT OF INVENTORIES

GQ. Explain Management of Inventories.

- For organizations with complex stock chains and assembling measures, adjusting the dangers of stock excesses and deficiencies is particularly troublesome. To accomplish these adjustments, firms have created two significant techniques for stock administration: in the nick of time (JIT) and materials necessity arranging (MRP).
- An organization's stock is one of its most significant resources. In retail, fabricating, food administration and other stock escalated areas, an organization's data sources and completed items are the center of its business. A deficiency of stock when and where it's required can be amazingly adverse.
- Simultaneously, stock can be considered as an obligation (if not in a bookkeeping sense). An enormous stock conveys the danger of waste, robbery, harm or moves popular. Stock should be protected, and in the event that it isn't sold in time it might need to be discarded at leeway costs or just annihilated.
- Thus, stock administration is significant for organizations of any size. Realizing when to restock stock, what adds up to buy or create, what cost to pay just as when to sell and at what cost can undoubtedly become complex choices.

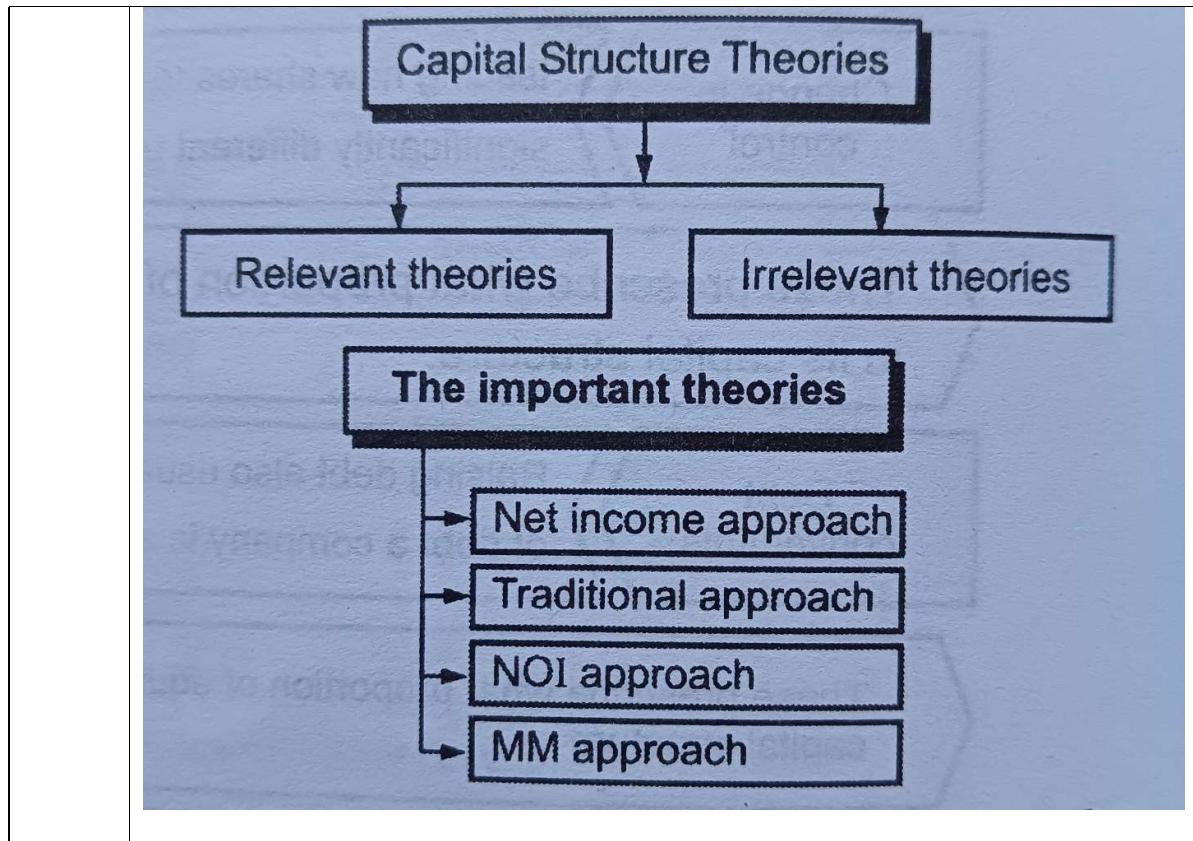
- Independent companies will frequently monitor stock physically and decide the reorder focuses and amounts utilizing Excel recipes.
- Bigger organizations will utilize specific undertaking asset arranging (ERP) programming. The biggest organizations utilize exceptionally redid programming as an assistance (SaaS) applications.
- Fitting stock administration techniques differ contingent upon the business. An oil warehouse can store a lot of stock for broadened timeframes, permitting it to trust that request will get.
- While putting away oil is costly and hazardous a fire in the UK in 2005 prompted a great many pounds in harm and fines there is no danger that the stock will ruin or become unfashionable.
- For organizations managing in short-lived merchandise or items for which request is incredibly time-delicate—2019 schedules or quick design things, for instance—sitting on stock isn't a choice, and misconstruing the circumstance or amounts of requests can be expensive.

Management of Cash and Marketable securities

- Motives for Holding Cash
- Objectives of Cash Management
- Factors Determining Cash Needs
- Determining Cash Needs
- Cash Management: Basic Strategies
- Cash Management Techniques/Processes
- Marketable Securities
- Solved Problem
- Mini Case

Fig. 4.8.1 ; Management of Cash and Marketable Securities

10 List various theories of capital structure. explain any one theory



5.5.4 Net Income Approach

GQ. Explain Net Income Approach.

- This methodology was recommended by Durand and he was supportive of monetary influence choice. As per him, a change in monetary influence would prompt an adjustment in the expense of capital.
- To put it plainly, if the proportion of obligation in the capital design builds, the weighted normal expense of capital abatements and subsequently the estimation of the firm increments. For more – Net Income Approach.

5.5.5 Net Operating Income Approach

GQ. Explain Net Operating Income Approach.

- This methodology is additionally given by Durand. It is inverse of the Net Income Approach if there are no expenses.
- This methodology says that the weighted normal expense of capital remaining parts consistent. It has confidence in the way that the market examinations a firm all in all and limits at a specific rate which has no connection to obligation value proportion.
- On the off chance that charge data is given, it suggests that with an increment owing debtors financing WACC decreases and estimation of the firm will begin expanding. For more – Net Operating Income Approach.

5.5.6 Traditional Approach

GQ. Write in Traditional Approach.

- This methodology doesn't characterize firm realities. It says that the expense of capital is an element of the capital design.
- The unique thing about this methodology is that it accepts an ideal capital construction.
- Ideal capital construction infers that at a specific proportion of obligation and value, the expense of capital is least and estimation of the firm is greatest. For more – Traditional Approach.

5.5.7 Modigliani-Miller Approach

GQ. Write in brief about Modigliani-Miller Approach.

It is a capital design hypothesis named after Franco Modigliani and Merton Miller. MM hypothesis proposed two suggestions.

- **Proposition I :** It says that the capital construction is unessential to the estimation of a firm. The estimation of two indistinguishable firms would continue as before and esteem would not effect by the decision of account received to fund the resources. The estimation of a firm is subject to the normal future income. It is when there are no assessments.
- **Proposition II :** It says that the monetary influence helps the estimation of a firm and lessens WACC. It is when charge data is free.

11 Define risk and return. Explain Measurement of Historical Returns and Expected Returns of a Single Security and a Two-security Portfolio

GQ. What is RISK ? Explain the variance of return ?

- The definition of risk that is often used in finance literature is created on the variability of the actual return since the predictable return. Statistical measures of variability are the variance and the standard deviation (the square root of the variance). Returning to the instance of A plc, we effort now calculate the variance and standard deviation of the earnings.

Market Conditions	[Actual return probability – expected return] ²		
Boom	$[30 - 20]^2$	0.1	10
Normal	$[20 - 20]^2$	0.8	0
Recession	$[10 - 20]^2$	0.1	10
Variance σ^2			20
Standard deviation $\sigma =$	$\sqrt{20}$	=	4.47

- The alteration of return is the subjective sum of squared deviations from the predictable return. The reason for squaring the deviations is to confirm that together positive and negative deviations donate similarly to the measure of predictability.

decreasing risk.

GQ. Explain Measurement of Historical Returns and Risk with example ?

2.1.1 Measurement of Historical Returns and Expected Returns of a Single Security

Historical returns

- You'll find various statistics about the historical revenues of stocks and bonds, and they can be frustratingly different from one source to another dependent on the data used, the period examined, and myriad other details.
- Nonetheless, a close examination of various data sets paints a pretty consistent picture. Two of the most repeatedly named data sets for historical stock and bond earnings are from **Yale Nobel Laureate Robert Shiller** and **Aswath Damodaran** of the Stern School of Industry at New York University. Refer Table 2.1.1.

Table 2.1.1

Data source	Stocks nominal average annualized return	10-year bond nominal average annualized return
Shiller 1871 through 2020	9.25%	Not Available
Damodaran 1928 through 2020	9.79%	4.95%

Of course, in some historical periods, stock and bond earnings varied substantially from the average annualized return, as this table of annual return statistics shows. Refer Table 2.1.2.

Table 2.1.2

Statistic	Stocks shiller	Stocks Damodaran	10-Year Bond Damodaran
Mean	10.88%	11.64%	5.21%
5 th Percentile	-18.71%	-23.23%	-4.98%
25 th Percentile	-0.79%	-1.19%	0.92%
Median	11.10%	14.22%	3.29%
75 th Percentile	23.09%	25.06%	8.79%
95 th Percentile	38.95%	39.81%	18.65%

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(Returns and Risks)....Page no. (2-3)

- You can see each year of annual returns by downloading the full data sets at the **Shiller** and **Damodaran** websites.
- Note that the "mean" value shown in this summary statistics table is an arithmetic average of annual returns, whereas the "average annualized returns" in the earlier table are calculated using a geometric average or Compound Average Growth Rate (CAGR).
- The average annualized return is normally a little lesser and a more precise measure of the earnings completed through investing steadily over many years.
- You may be interested in determining annualized returns for specific historical periods. These two calculators provide annualized stock and bond earnings (nominal and inflation adjusted) between any two periods based on the Shiller and Damodaran datasets, respectively.

Historical risks

- Stock returns have historically outpaced bond returns by 4 to 5%. So, this seems like a compelling case for investing in stocks. But we need to also look at the risk side of the equation.
- Here are some simple statistics on the ups and downs ("volatility" as dignified by standard deviation) of stocks and bonds from a **Vanguard study** using data starting in 1926, with annual standard deviations added from the Shiller and Damodaran datasets, respectively : Refer Table 2.1.3.

Table 2.1.3

Statistic	Stocks	Government Bonds
Return in best year	54.2%	45.5%
Return in worst year	-43.1%	-8.1%
Years with a loss	25	19
Standard deviation	18.6%	7.7%

- As you can see, stocks have a wider range of ups and downs (volatility), and in a single very bad year, you could lose about half your investment value. In comparison, bonds have much less potential for large annual losses and had fewer years where a loss occurred. So, we can start to see why return and risk are normally assumed to be linked.

GQ. Explain A Two Security Portfolio ?

2.2.2 A Two Security Portfolio

The formulae for the standard deviation of returns of a two-asset portfolio

$$\text{Version 1} \quad \sigma_{\text{port}}(A, B) = \sqrt{\sigma_a^2 x^2 + \sigma_b^2 (1-x)^2 + 2x(1-x) \text{cov}(R_A, R_B)}$$

$$\text{Version 2} \quad \sigma_{\text{port}}(A, B) = \sqrt{\sigma_a^2 x^2 + \sigma_b^2 (1-x)^2 + 2x(1-x) \rho_{ab} \sigma_a \sigma_b}$$

(given on formula sheet in the exam)

- The first two relations contract through the risk of the separable investments. The third term is the most exciting one as it contemplates the way in which the takings on each pair of investments co vary.
- The covariance period is grown by twice the parts advanced in every investment, as it reflects the covariance of A and B and of B and A, which stay of sequence the same.
- Reminder the only alteration between the two forms is that the covariance in the next type is broken down into its essential parts, i.e.

$$\text{cov}_{ab} = \rho_{ab} \sigma_a \sigma_b$$

- Based on the first version of the formula :

$$\sigma_{\text{port}}(A, B) = \sqrt{4.47^2 \times 0.5^2 + 4.47^2 \times 0.5^2 + 2 \times 0.5 \times 0.5 \times 20} = 4.47$$

The second version of the formula is the one that is nearly always used in exams and it is the one that is given on the formula sheet.

$$\sigma_{\text{port}}(A, B) = \sqrt{4.47^2 \times 0.5^2 + 4.47^2 \times 0.5^2 + 2 \times 0.5 \times 0.5 \times 1 \times 4.47 \times 4.47} = 4.47$$

$$\sigma_{\text{port}}(A, C) = \sqrt{4.47^2 \times 0.5^2 + 4.47^2 \times 0.5^2 + 2 \times 0.5 \times 0.5 \times -1 \times 4.47 \times 4.47} = 0.00$$

$$\sigma_{\text{port}}(A, D) = \sqrt{4.47^2 \times 0.5^2 + 4.47^2 \times 0.5^2 + 2 \times 0.5 \times 0.5 \times 0 \times 4.47 \times 4.47} = 3.16$$

Summary table investment	Expected return (%)	Standard deviation (%)
Port A + B	20	4.47
Port A + C	20	0.00
Port A + D	20	3.16

- A + C is the most effective portfolio as it has the lowermost level of risk for a specified level of arrival. Perfect negative association does not follow between the takings on two investments in the actual world, ie risk cannot be reduced, however it is valuable to identify the abstract excesses. Though, as previously specified, in certainty the correlation factors between earnings on investments tend to lie amongst 0 and +1.
- Indeed, the earnings on investments in the identical industry incline to require a high positive association of roughly 0.9, although the proceeds on investments in dissimilar industries tend to require a small positive association of around 0.2. Thus investors have a favorite to invest in dissimilar industries thus pointing to create a well diversified portfolio, confirming that the determined risk decrease effect is acquired.
- Based on our initial considerate of the risk return association, if depositors wish to moderate their risk they will have to admit a summary return. However, portfolio theory displays us that it is expected to moderate risk without consuming a important decline in return.
- This can be verified quite easily, as a portfolio's predictable arrival is identical to the weighted normal of the predictable returns on the distinct investments, whereas a portfolio's risk is less than the biased normal of the risk of the separate savings due to the risk discount effect of change caused by the correlation coefficient being less than +1.

(New Syllabus w.e.f academic year 19-20) (M8-48)



Tech-Neo Publications...A SACHIN SHAH Venture

12	Explain Financial Statements—Balance Sheet, Profit and Loss Account, and Cash Flow Statement
13	Explain various decisions in corporate finance. Also explain Current ratio, Quick ratio and composite ratio

	<p>The kinds of liquidity ratios are :</p> <p>(i) Current Ratio : The current ratio is the ratio connecting the current assets and current liabilities of a company. The current ratio is used to point to the liquidity of an association in organism able to assemble its debt obligation in the future twelve months. A superior current ratio will specify that the association is extremely capable of repay its short-term debt obligation.</p> $\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$
14	What are financial institutions? Explain various types in detail

► (1) Financial Institutes**GQ.** What are types of Financial Institutions ?

Financial institutes are mediators of financial markets which simplify financial transactions between persons and financial regulars.

There can be two kinds of financial institutes :

1. **Banking Institutes or Depository institutes** : These stand banks and credit mergers that gather money since the public in return for awareness on money credits and use that money to early payment loans to financial customers.
2. **Non Banking Institutes or Non Depository institutes** : These stand brokerage companies, insurance and mutual funds firms that cannot accumulate money credits but can sell financial products to financial customers.

❖ 1.1.2 Financial Institutions Characteristics

Financial Institutions may be categorized into three classifications : Characteristics

- **Governing** : It contains institutions like S E B I, RBI, I R D A. which normalize the financial marketplaces and defend the interests of depositors.
 - **Mediators** : It contains profitable banks such as S B I, P N B that offer small term loans and other financial services to individuals and corporate customers.
 - **Non Mediators** : It contains financial institutes similar N A B A R D, I D B I that offer long-term loans to commercial customers.
1. **Financial Marketplaces** : It mentions to any marketplace wherever buyers and sellers contribute in transaction of resources such as shares , bonds , currencies and other financial instruments.
A financial marketplace may be additional allocated into capital marketplace and money market.
 2. **Financial Assets / Instruments** : Financial resources contain cash securities, forms, loans, interpretations receivable, letter of thanks, bank records and all additional financial instruments that offer a claim alongside a person /financial organization to pay whichever a precise amount on a assured future date or to pay the principal amount laterly with interest.
 3. **Financial Facilities** : Financial Services are concerned with the plan and supply of financial instruments and suggested amenities to entities and industries inside the area of banking and connected institutions, personal financial preparation, leasing, investment, assets, insurance etc.

❖ 1.1.3 Functions of Indian Financial Organization**GQ.** Explain the India Financial System? Explain the characteristics also.

- It associations the gap between savings and investment through effective organization and allocation of extra funds.
- It benefits a business in capital development.
- It benefits in reducing risk and assigning risk competently.
- It benefits a business to settle tied up funds.
- It assists financial dealings through providing of numerous financial instruments.
- It facilitate trading of financial assets/instruments by increasing and modifiable financial markets.

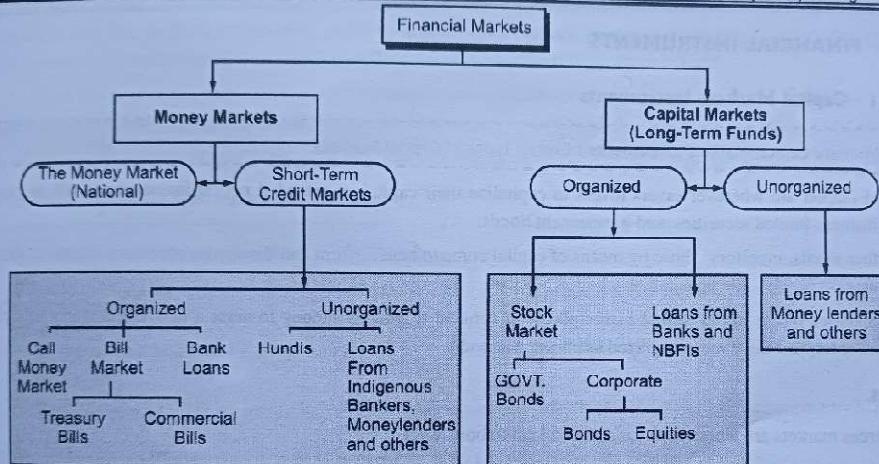


Fig. 1.1.2 : Functional-cum-Institutional Classification of Financial Markets

- Functionally, financial markets are generally sub distributed under two heads money marketplaces and capital marketplaces. The previous are markets in small term funds, the final in long period funds.
- We require inferred the term money marketplace more approximately to contain inside its folding also the estimated money market of economic theory.
- This marketplace is co terminus with the whole economy. The strength it contracts in is money; the demanders are the holders of money and the providers are the management, the RBI and banks'.
- Money itself is learned in the usual process of selling things, amenities, and resources in all marketplaces, as money is the mutual medium of interchange.

15	<p>Julie Miller is evaluating a new project for her firm, Basket Wonders (BW). She has determined that the after-tax cash flows for the project will be \$10,000; \$12,000; \$15,000; \$10,000; and \$7,000, respectively, for each of the Years 1 through 5. The initial cash outlay will be \$40,000.</p> <p>Calculate payback period. also comment on strength and weakness of payback period</p>
16	Differentiate between ordinary annuity and annuity due with examples.
17	<p>Explain any 5 types of money market instruments in brief.</p> <p>GQ: What are the Kinds of money marketplace instruments in India ?</p> <p>Below are the kinds of money market instruments :</p> <p>1. Treasury Bills</p> <ul style="list-style-type: none"> - T bills are unique of the majority admired money market instruments. They have changeable short term maturities. The Government of India concerns it at a reduction for 14 days to 364 days. - These tools are matter at a reduction and repay at par at the period of maturity. Also, a company, stable , or person can acquire TB's. And are issue in lots of Rs. 25,000 for 14 days and 91 days and Rs. 1,00,000 for 364 days. <p>2. Commercial Bills</p> <ul style="list-style-type: none"> - Profitable bills, also a money market instrument, work more like the bill of exchange. business issue them to meet their short term moncy necessities. - These instruments present much better liquidity. As the same can be transfer from one person to another in case of instant cash necessities.

	<p>3. Certificate of Deposit</p> <ul style="list-style-type: none"> - Certificate of deposit or CD's is a flexible term deposit conventional by commercial banks. It is typically issued from side to side a promissory note. - CD's can be matter to persons, corporations, trusts, etc. Also, the CD's can be concern by schedule marketable banks at a discount. - And the period of these differs between 3 months near 1 year. The same, when allotted by a financial institute, is issue for a minimum of 1 year and a extreme of 3 years. <p>4. Salable Paper</p> <ul style="list-style-type: none"> - Corporates issue C P's to meet their small term functioning capital supplies. - Hence serve as an another to borrow from a bank. Also, the period of profitable paper kinds from 15 days to 1 year. - The Reserve Bank of India puts down the policy connected to the concern of CP's. - As a effect, a company require RBI's prior sanction to subject a C P in the marketplace. - Also , C P has to be matter at a reduce to face price. And the market chooses the discount rate. <p>Denomination and the scope of C P</p> <p>Smallest size – Rs. 2 5 lakhs</p> <p>Extreme size – 100 % of the issuer's working wealth</p> <p>5. Call Money</p> <ul style="list-style-type: none"> - It is a sector of the marketplace where planned marketable banks offer or borrow on small notice (Approximately a period of 1 4 days). In order to handle day to day cash flows. - The interest rates in the market are marketplace driven and therefore highly responsive to command and supply. Also, the interest rates have been recognized to change by a large % at confident times.
18	Describe the relation between Capital Structure and Corporate Value.

► 5.6 RELATION BETWEEN CAPITAL STRUCTURE AND CORPORATE VALUE

GQ. Explain Relation between Capital Structure and Corporate Value.

- Firm activates reserves which, contingent on their development period can be named long haul and transient sources.
 - The previous comprises of capital, holds and term advances raised from public and monetary establishments, while the last is comprised of current liabilities and arrangements.
 - Financing choices include raising assets for the organizations. It is worried about detailing and planning of capital construction or influence.
 - While venture choices are identified with the resource side of the accounting report, financing choices are identified with the liabilities and value side.
 - Capital construction conventionally suggests the extent of obligation and value in the complete capital of an organization.
 - Since an organization may tap any at least one of the diverse accessible wellsprings of assets to meet its all-out monetary necessity.
 - The complete capital of an organization may, accordingly, be made out of all such tapped sources. The term 'structure' has been related with the term 'capital'. The term 'capital' might be characterized as the drawn out assets of the firm.
 - Capital is the total of the things showing up on the left hand side of the monetary record less current liabilities.
 - As such, capital may likewise be communicated as absolute resources less current liabilities. Further, capital of an organization may comprehensively be ordered into 'value' and 'obligation'.
- Value share capital + Preference share capital + Share premium + Free holds + Surplus benefits + Discretionary arrangements for possibility + Development refund save
- 'Monetary design' in the whole left hand side of the organization's accounting report which incorporates current liabilities (comparable to resource structure).
 - While 'capital design' alludes to wellsprings of long haul reserves. The term 'complete capital construction' indicates blend of proprietors' assets and pariahs' assets or it is proportionate relationship of company's lasting long haul financing addressed by value and obligation.
 - Conventionally, increment owing debtors in the capital construction i.e., improvement of obligation value proportion suggests more prominent measure of interest installment than previously.
 - Thus, the organization should must be certain enough of getting consistent return to bear the extra weight of interest. Similarly, productivity depends; *bury alia*, on expense of capital.
 - In reality, a negative relationship ought to consistently exist between cost of capital and productivity. Thus, increment in expense of capital methods decline in benefit.
 - Since acknowledgment of increasingly more obligation implies installment of more prominent measure of interest, the organization should have to mull over its impact on productivity.
 - In the event that because of acknowledgment of obligation, productivity diminishes. A negative relationship results, such obligation acknowledgment won't be invaluable to the organization.

The again, if any adjustment in the capital design via expanding the extent of obligation can have ideal impact on benefit, at that point such change i.e., increment paying off debtors might be viewed as valuable to the organization.

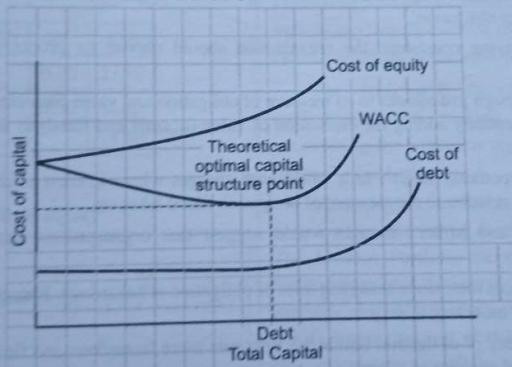


Fig. 5.6.1

19 What are the factors affecting an Entity's Working Capital Needs?

► 4.6 FACTORS AFFECTING AN ENTITY'S WORKING CAPITAL NEEDS

GQ. Explain Factors Affecting an Entity's Working Capital.

Factors Influencing or Affecting Fixed Capital Requirement

1. Nature of business is the most crucial factor of all that significantly affects its fixed capital requirement.
2. Size of business has a direct relationship with its fixed capital need or requirement.
3. The availability of fixed capital impacts the scale of operation.
4. Modern technologies demand more fixed capital than traditional ones.
5. Manufacturing of complex products need more fixed capital than what amount is required for making simple products.
6. The scope of activities determines fixed capital needs of a business.
7. The method of acquiring assets for business use influence it.
8. The allocation of subsidy by government also has an influence on it.
9. Lifetime of assets, AMC, sustainability of project, stages in development of a business, etc., also influence fixed capital needs.

Fig. 4.6.1 : Factors Affecting an Entity's Working Capital

The firm should gauge its working capital precisely on the grounds that exorbitant working capital outcomes in pointless aggregation of stock and wastage of capital though deficiency of working capital influences the smooth progression of working cycle and business neglects to meet its responsibility.

So money supervisor should gauge perfect measure of working capital. The account administrator should remember following elements prior to assessing the measure of working capital.

1. Length of Operating Cycle

- The measure of working capital straightforwardly relies on the length of working cycle.
- Working cycle alludes to the time-frame engaged with creation. It begins directly from obtaining of crude material and finishes till installment is gotten after deal.
- The working capital is vital for the smooth progression of working cycle.
- In the event that working cycle is long, at that point seriously working capital is required though for organizations having short working cycle, the working capital prerequisite is less.

2. Nature of Business

- The kind of business, firm is associated with, is the following thought while choosing the working capital.
- If there should arise an occurrence of exchanging concern or retail shop the necessity of working capital is less on the grounds that length of working cycle is little.

FACTORS DETERMINING WORKING CAPITAL REQUIREMENT

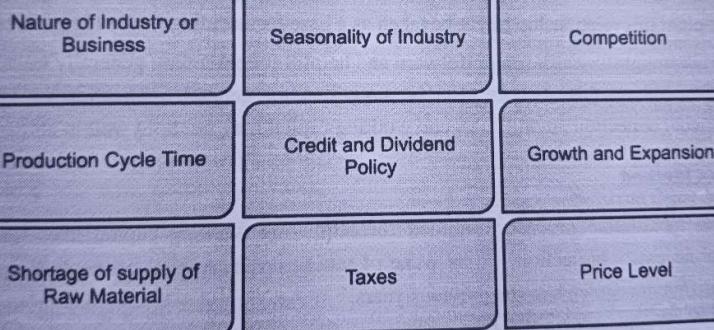


Fig. 4.6.2 : Factors Affecting an Entity's Working Capital Requirement

20	Briefly explain the types of financial services
21	How does one manage the receivables under working capital management?
21	<p>4.8.1 Management of Receivables and Management of Cash and Marketable Securities</p> <p>GQ. Write in brief about Management of Receivables and Management of Cash and Marketable Securities.</p> <ul style="list-style-type: none"> - Money and attractive protections are the most fluid of an organization's resources. Money is the amount of the cash an organization has close by and the assets on store in bank financial records. - Money is the mode of trade that licenses the board to carry on the different elements of the business association. Truth be told, the endurance of an organization can rely upon the accessibility of money to meet monetary commitments on schedule. - Attractive protections comprise of transient ventures a firm makes with its briefly inactive money. Attractive protections can be sold rapidly and changed over into money when required. In contrast to money, be that as it may, attractive protections furnish a firm with revenue pay. - Viable money and attractive protections the board is significant in contemporary organizations, government offices, and not-revenue driven endeavors. - Corporate financial officers constantly look for approaches to expand the yields on their fluid money and attractive security saves. - Customarily, these fluid stores were put solely in debatable authentications of store, Treasury charges, business paper, and repurchase arrangements (transient credits upheld by Treasury securities). - However, as of late numerous financiers have demonstrated a readiness to face some extra challenges to build the profit for fluid resources. Monetary supervisors continually face these kinds of danger return compromises. - Numerous organizations hold critical money and attractive protections adjusts. For instance, toward the finish of 2003, Ford had a money surplus of almost \$26 billion. As we found in the "Monetary <p>F - I-N Publications A SACHIN SHAH Venture</p> <ul style="list-style-type: none"> - Challenge" toward the start of the part, Microsoft's money surplus was \$56 billion and developing (i.e., free income) at a pace of \$1 billion every month. - These money adjusts give the firm a pad to deal with monetary slumps and the capacity to make interests in different firms when the cost is appealing. - Huge money adjusts can make firms alluring takeover focuses for corporate marauders, who look to redeploy these overflow assets in more beneficial manners. - For instance, Kirk Kerkorian, Chrysler's biggest investor, made a fruitless buyout offer for the organization in 1995. - He guaranteed that Chrysler's \$7.3 billion money store was an overabundance for its tasks and that a portion of this crowd ought to be paid out to investors—either as money profits or offer repurchases. - Notwithstanding dealing with the money and attractive protections effectively in the company's ownership, monetary chiefs likewise forcefully look to accelerate money assortments from clients and to hinder distributions to providers. - For instance, when Alaska sold its oil leases for \$900 million, the state was paid with watches that needed to genuinely arrive at New York before the state could gather and contribute the assets. - The state sanctioned a plane to take the checks to New York, hence saving one day on the way over business transporters. The day by day interest on these assets at the time was almost \$200,000, and the plane contract cost just \$15,000, coming about in \$185,000 of extra re-visitations of the state. - Money administrators ceaselessly search for approaches to diminish the assortment and clearing time for checks got by the firm with the goal that the assets can be given something to do acquiring a return.

	Should the company invest in the project?																
23	<p>The shares of Armstrong company has the following anticipated returns with associated probabilities:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Return (%)</th><th>-20</th><th>-10</th><th>10</th><th>15</th><th>20</th><th>25</th><th>30</th></tr> <tr> <th>Probability</th><td>0.05</td><td>0.10</td><td>0.20</td><td>0.25</td><td>0.20</td><td>0.15</td><td>0.05</td></tr> </thead> </table> <p><i>Calculate the expected rate of return and risk measures in terms of variance & standard deviation.</i></p>	Return (%)	-20	-10	10	15	20	25	30	Probability	0.05	0.10	0.20	0.25	0.20	0.15	0.05
Return (%)	-20	-10	10	15	20	25	30										
Probability	0.05	0.10	0.20	0.25	0.20	0.15	0.05										
24	Explain with suitable example the concept & importance of Economic Order Quantity.																