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Course Code: BCOE 143

Course Title: Fundamentals of financial Management.

Assignment Number: BCOE-143/TMA/2025-26

Study Center Code: 07189

Submission Date: 05-11-2025

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Bachelor of Commerce (General)

B.Com G

CHOICE BASED CREDIT SYSTEM

BCOE – 143: FUNDAMENTALS OF FINANCIAL MANAGEMENT

ASSIGNMENT

2025-2026

Valid from 1st July 2025 to 30th June 2026

Fifth Semester

School of Management Studies

Indira Gandhi National Open University

Maidan Garhi, New Delhi -110068

BACHELOR OF COMMERCE (GENERAL)
CHOICE BASED CREDIT SYSTEM
BCOE – 143: FUNDAMENTALS OF FINANCIAL MANAGEMENT

ASSIGNMENT: 2025-26

Dear Students,

As explained in the Programme Guide, you have to do one Tutor Marked Assignment in this Course. The assignment has been divided into three sections. Attempt all the three sections.

Assignment is given 30% weightage in the final assessment. To be eligible to appear in the Term-end examination, it is compulsory for you to submit the assignment as per the schedule. Before attempting the assignments, you should carefully read the instructions given in the Programme Guide.

1. Those students who are appearing in December 2025 Term End Examination they have to submit latest by in 15 October 2025.
2. Those students who are appearing in June 2026 Term End Examination they have to submit latest by in 15 March 2026.

You have to submit the assignment of all the courses to the Coordinator of your Study Centre.

TUTOR MARKED ASSIGNMENT

COURSE CODE	**:**	**BCOE – 143**
COURSE TITLE	**:**	**FUNDAMENTALS OF FINANCIAL MANAGEMENT**
ASSIGNMENT CODE	**:**	**BCOE – 143/TMA/2025-26**
COVERAGE	**:**	**ALL BLOCKS**

Maximum Marks: 100

Note: Attempt all the questions.

Section – A
(Attempt all the questions. Each question carries 10 marks.)

1. Explain the various steps involved in capital budgeting process. **(10)**

2. What is capital rationin? Explain the process of capital rationing with suitable example. **(10)**

3. What is cost of capital and why is it important for financial decision making? **(10)**

4. Discuss the effect of corporate taxes on corporate valuation? How does the MM approach integrate corporate taxes into valuation model? **(10)**

5. Discuss accounting rate of return method for making capital budgeting decisions with suitable examples. **(10)**

Section – B
(Attempt all the questions. Each question carries 6 marks.)

6. Define bond and types of bonds. **(6)**

7. When does financial leverage become favourable? Discuss its impact on risk. **(6)**

8. How is the valuation of firms done based on dividends? **(6)**

9. Explain the implication of Walter's model. **(6)**

10. What is CEC method? State its merits and demerits. **(6)**

Section – C
(Attempt all the questions. Each question carries 10 marks.)

11. **Write short notes on:** **(5x2)**
- **a)** Time Value of Money
- **b)** Residual Theory of dividend

12. **Distinguish between:** **(5x2)**
- **a)** Systematic Risk and Un-Systematic Risk
- **b)** Gross operating cycle and Net working capital

BCOE - 143

Fundamentals of Financial Management

Section-A

Q.1) Explain the various step involved in capital budgeting process.

Ans) Capital budgeting is the process a business undertakes to evaluate potential major projects or investments.
The process involves several systematic steps:

1. Project Identification and Generation :- The first step is to identify potential investment opportunities.

2. Project screening and Evaluation :- Once a pool of potential projects is identified, they are screened to weed out unviable or inconsistent proposals. The remaining projects are then evaluated in detail.

3. Project selection :- this is the core of capital budgeting. After evaluating the projects, the firm uses various capital budgeting

techniques to select the profitable ones. these techniques include :-

- Non-Discounted Methods :- Payback period and Accounting Rate of Return (ARR)
- Discounted Cash Flow (DCF) Methods :- Net present value (NPV), Internal Rate of Return (IRR) and Profitability Index (PI).

4. Capital Rationing and Final Approval :- In many cases, a firm may have more profitable projects than it has funds to invest. this situation is known as capital rationing.

5. Project Implementation :- After a project is approved, the funds are allocated, and the project is implemented. this phase involves acquiring assets, construction, and bringing the project to the operational stage.

6. Performance Review (Post-Audit) :- the final step is a post-completion audit. this involve comparing the actual cost and benefits of the project with the initial projections.

8.2) What is capital rationing ? Explain the process of capital rationing with suitable example.

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Any capital rationing is a situation where a company has more profitable investment opportunities (project with a positive Net Present value) than it has funds to invest in them.

Process of capital Rationing

The most widely accepted method for project selection under capital rationing (for single period rationing) is the Profitability Index (PI) method. The process involves the following steps:

1. Calculate the Net Present value (NPV) for each potential project.

2. Calculate the Profitability Index (PI) for each project using the formula:-
$ PI = \frac{Present value of Future cash Inflows}{Initial Investment} or \frac{NPV + Initial Investment}{initial Investment} $

3. Rank the projects in descending order based on their

4. Starting from the top of the ranked list, select projects until the entire capital budget is exhausted.

Example:-

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suppose a company has a budget of ₹ 50,000 and is considering the following five projects:

Project	Initial Investment (₹)	NPV (₹)	PI	Rank
A	20,000	8,000	1.40	1
B	15,000	4,500	1.30	3
C	25,000	7,500	1.30	3
D	10,000	3,500	1.35	2
E	5,000	1,500	1.30	3

Conclusion :-

The company should invest in Projects A, D, B, E. This combination uses the entire budget of ₹ 50,000 and maximizes the total NPV (₹ 80,00 + ₹ 3,500 + ₹ 4,500 + ₹ 1,500 = ₹ 17,500).

Q.3) What is cost of capital and why is it important for financial decision making?

Ans) The cost of capital is the minimum rate of return that a company must earn on its investments to maintain the market value of its equity. It is the overall cost a company incurs to raise funds from various sources including debt, equity and retained earnings.

Essentially, it is the opportunity cost for the investors who provide capital to the

firm.

Importance in Financial Decision Making:

The cost of capital is one of the most critical concepts in financial management for several reasons :-

1. Capital Budgeting Decisions :- The cost of capital serves as the primary discount rate (or hurdle rate) for evaluating investment projects. In the Net Present Value (NPV) method, future cash flows are discounted at the cost of capital. A project is accepted only if its NPV is positive, meaning its expected return is greater than the cost of capital. In the Internal Rate of Return (IRR) method, a project is accepted only if its IRR is higher than the cost of capital.

2. Designing the capital structure :- the cost of capital is a key factor in determining the optimal mix of debt and equity for a firm.

3. Evaluating Financial performance :- the cost of capital can be used as a benchmark to evaluate the performance of different divisions or the firm as a whole. A positive EVA indi-

-cates that the firm is creating value for its shareholders.

4. Dividend Policy Decisions :- the cost of capital is used in dividend valuation models to determine the market price of a share. theories like Walter's model use the cost of capital to decide whether a firm should retain its earnings for reinvestment or distribute them as dividends.

Q4) Discuss the effect of corporate taxes on corporate valuation? How does the MM approach integrate corporate taxes into valuation model?

Ans) corporate taxes have a significant effect on corporate valuation, primarily through the treatment of interest on debt. while dividends paid to shareholders are paid out after-tax profit the interest paid to debtholders is a tax-deductible expense.

the Modigliani-Miller (MM) approach, in its initial 1958 proposition, argued that in a world with no taxes, a company value is unaffected by it capital structure (the mix of debt and equity) however, in their 1963 correction, they introduced corporate taxes and showed

that capital structure becomes relevant.

MM Approach with corporate Taxes :-

the MM Model integrates corporate taxes by recognizing that the use of debt provides a valuable tax shield.

the value of a levered firm (a firm with debt) is equal to the value of an identical unlevered firm (a firm with no debt) plus the present value of the tax shield generated by the debt.

the valuation model is expressed as:
$$V_L = V_U + T_c \times D$$

Where :-
- V_L = value of the levered firm
- V_U = value of the unlevered firm
- T_c = corporate tax rate
- D = Market value of debt

Implications of the Model :-

- Debt Increases Firm value :- According to this model, the value of the firm increases as it uses more debt in its capital structure.

- WACC decreases with Leverage :- As the firm uses more cheap, tax-advantaged

debt, its weighted Average cost of capital (WACC) decreases.

this model demonstrates that because of the tax advantage of debt, a firm's capital structure matters and it can increase its value by taking on leverage.

Q.5) Discuss accounting rate of return method for making capital budgeting decisions with suitable examples.

Ans) the Accounting Rate of Return (ARR) also known as the Average Rate of Return, is a non-discounted capital budgeting technique used to evaluate the profitability of an investment.

the formula for ARR is :-

$$ARR = \frac{\text{Average Annual Profit After Tax}}{\text{Average Investment}} \times 100$$

where :-

- Average Annual Profit After Tax :- (Total Profit After tax over the project's life) / (Number of years)
- Average Investment = (Initial Investment + salvage value) / 2

Decision Rule :- A project is accepted if its ARR is greater than the management's pre-

- determined minimum required rate of return.

Example 1 :- Single Project

A company is considering a project that requires an initial investment of ₹100,000 the project has a life of 5 years and no salvage value. the estimated profit after tax for the 5 years are :-

- Year 1 :- ₹10,000
- Year 2 :- ₹12,000
- Year 3 :- ₹15,000
- Year 4 :- ₹18,000
- Year 5 :- ₹20,000

the company is required rate of return is 15 %.

calculation :-

1. Total Profit After Tax :- ₹10,000 + ₹12,000 + ₹15,000 + ₹18,000 + ₹20,000 = ₹75,000

2. Average Annual Profit :- ₹75,000 / 5 = ₹15,000

3. Average Investment :- (₹100,000 + ₹0) / 2 = ₹50,000

4. ARR :- (₹15,000 / ₹50,000) * 100 = 30 %.

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Section - B

Q.6) Define bond and types of bonds.

Ans) A bond is a type of debt security or financial instrument where an investor lends money to an entity (typically a corporation or a government) for a defined period at a fixed or variable interest rate.

Types of Bonds :-

1. Government Bonds (G-secs) :- Issued by a national government to raise capital. They are generally considered very low-risk as they are backed by the full faith and credit of the government

2. Corporate Bonds :- Issued by a companies to fund their capital requirements, such as for expansion or R & D.

3. Zero-coupon Bonds : these bonds do not pay periodic interest (coupons). Instead, they are issued at a deep discount to their face value and are redeemed at face value upon maturity.

4. Convertible Bonds :- A type of corporate bonds that gives that gives the holder the option to convert the bond into a

specified number of shares of the issuing company's common stock.

5. Callable Bonds :- These bonds can be redeemed or "called" by the issuer before the maturity date.

Q.7) When does financial leverage become favourable? Discuss its impact on risk.

Ans) Financial leverage refers to the use of borrowed funds (debt) to finance a company's assets.

When Financial leverage is Favourable :-

Financial leverage becomes favourable when the company earns a higher rate of return on its investment (or asset) than the interest rate it pays on its debt. This situation is often referred to as "trading on equity".

the condition for favourable leverage is :-

Return on Investment (ROI) > cost of Debt (Interest Rate)

Impact on Risk :-

While favourable leverage can magnify returns, it also significantly increases risk.

- Magnification of losses :- If the company's ROI falls below the cost of debt, leverage becomes unfavorable and magnifies the losses for shareholders.

- Increased Financial Risk :- Financial risk is the risk to shareholders that arises from the use of debt.

Q.8) How is the valuation of firms done based on dividends ?

Ans) Valuing a firm based on its dividend is a fundamental method of equity valuation. the core principle is that the intrinsic value of a company is stock is the present value of all its expected future dividends.

The general formula for the DDM is :-

$$P_0 = \frac{D_1}{(1 + K_e)^1} + \frac{D_2}{(1 + K_e)^2} + \frac{D_3}{(1 + K_e)^3} + \dots$$

Where :-

- P_0 = current stock price (value of the firm's equity)
- $D_1, D_2 \dots$ = Expected dividends per share in year 1, year 2 and so on.
- K_e = cost of equity or the required rate of return for shareholders.

Since forecasting dividends indefinitely is

impractical, different versions of the DDM are used based on assumptions about dividend growth.

1. Zero Growth DDM: Assumes dividends will remain constant forever.

2. Constant Growth DDM (Gordon Growth Model): this is the most common model. It assumes that dividends will grow at a constant rate (g) forever.

3. Multi-stage (or variable) Growth Model: this is a more complex model used for companies that are expected to go through different phases of growth.

Q.9) Explain the implications of Walter's model.

Ans) Walter's model, developed by Professor James E. Walter, is a dividend policy model that argues that a firm's dividend policy is relevant and has a direct impact on the value of its stock.

The formula of Walter's Model is:-

$$P = \frac{D}{K} + \frac{\frac{r}{K}(E-D)}{K}$$

Where:-

- P = Market price per share
- D = Dividend per share
- E = Earnings per share

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r = Firm's internal rate of return
k = Firm's cost of capital (or required rate of return)

Implications of Walter's Model:-

the model leads of three distinct implications for a firm's optimal dividend policy:-

1. Growth Firms ($r > k$): If the firms earns a higher returns on its investments than its cost of capital, it is considered a growth firm.

2. Normal Firm ($r = k$): If the firm's return on investment is equal to its cost of capital, the firm is a normal firm.

3. Declining Firms ($r < k$):- If the firm's return on investment is less than its cost of capital, it is a declining firm.

In essence, Walter's model provides a clear framework linking a firm's investment opportunities to its dividend policy to maximize shareholder wealth.

Q.10) What is CEC method? state its merit and demerits?

Ans) the certainty Equivalent Coefficient (CEC) method is a risk-adjustment technique

used in capital budgeting to account for the risk associated with a project is future cash flows.

Merits :-

1. Simplicity :- the concept is intuitive and easy to understand. It provides a straightforward way to incorporate the decision-maker's risk perception into the analysis.

2. Seperate Risk and Time Preference :- Unlike the risk-adjusted discount rate method the CEC method seperates them.

Demerits :-

1. Subjectivity :- the biggest drawback is that the process of determining the certainty equivalent coefficient (α) is highly subjective.

2. Difficulty in Application :- It is very difficult in practice to find a manager willing or able to specify the exact amount of certain cash.

3. Inconsistent Risk perception :- Different managers may have different risk perceptions leading to different valuations for the same project, which can create inconsistence in decision-maming across the firm.

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Section-C

Q.11) Write short notes on :-

(a) Time value of Money

Ans) The time value of money (TVM) is the fundamental financial concept that a sum of money is worth more now than the same sum will be at a future date. This is due to its potential earning capacity. A rupee received today can be invested to earn interest, growing to a larger amount in the future. Conversely, a rupee received in the future is worth less today because of the opportunity cost of not having it now.

This principle is driven by factors like inflation (money loses purchasing power over time), risk (the future is uncertain) and the opportunity to earn a return. TVM is the foundation of all financial valuation. Techniques like compounding (calculating the future value of a present sum) and discounting (calculating the present value of a future sum) are used to compare cash flows occurring at different points in time, making it a cornerstone of capital budgeting, bond

valuation and retirement planning.

(b) Residual theory of dividend

Any the Residual theory of Dividend proposes that a company's dividend policy is a passive decision, not an active one. According to this theory, a firm should prioritize its investment opportunities over paying dividends. The theory suggest that a firm should follow these steps to determine its dividend payout :-

1. Identify and evaluate all profitable investment opportunities (projects with a positive NPV).

2. Determine the total amount of equity financial needed to fund these projects while maintaining its target capital structure.

3. Use its retained earnings to supply this equity financing first.

4. If there are any profits over (the "residue") after financing all profitable projects, these residual earnings should be paid out to shareholders as dividend.

the implication is that dividends are not

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stable. In a year with many profitable projects, the dividend may be zero. In a year with few profitable project the dividend could be very high. the primary focus on the firm is to maximize shareholder wealth through investment, and dividends are simply the leftover profits.

Q.12) Distinguish between :-

(a) Systematic Risk and Un-systematic Risk

Basis of distinction	Systematic Risk	Un-systematic Risk
Definition	Risk inherent to the entire market or market segment. It affects all securities in the market	Risk that is unique to a specific company or industry. It affect only a particular stock or a small group of stocks
controllability	It is uncontrollable and cannot be eliminated through diversification.	It is controllable and can be reduced or eliminated by holding a well-diversified portfolio.
causes	caused by macro-economic factors like changes in interest rates, inflation	caused by micro-economic factors specific to a company, such as

	Wars, political instability and recessions.	labor strikes, poor management decisions or a new competitor.
Also known as	Market Risk or Undiversifiable Risk.	Specific Risk, Diversifiable Risk or Idiosyncratic Risk.
Measurement	Measured by Beta (β), which indicates a stock volatility relative to the overall market.	Not typically measured by a single metric, as it is specific to the asset.
Example	A global recession that causes the entire stock market to fall.	A fire at a company's main factory that causes its stock price to drop, while the rest of the market is unaffected.

(b) Gross operating cycle and Net working capital

Basis of Distinction	Gross operating cycle	Net working capital
Definition	The total time elapsed from the procurement of raw materials to the final collection of cash from customer after the sale of finished goods.	A measure of a company's liquidity operational efficiency and short-term financial health.

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Formula	Gross operating cycle = Inventory conversion period + Debtors (Receivables) conversion period.	Net working capital = current Assets − current liabilities.
What it measures	It measures the efficiency of the business operations in converting inputs into cash. It is measured in days.	It measures the company's liquidity position. It is a monetary value (e.g. in rupees).
Interpretation	A shorter cycle indicates greater efficiency, as the company needs less time to generate cash from its operations.	A positive value indicates that the company can meet its short-term obligations. A negative value can be a sign of financial distress.
Objective	the financial manager's objective is to shorten or minimize the operating cycle to improve cash flow.	the objective is to maintain an optimal level of net working capital — enough for liquidity without tying up excess cash in unproductive assets.

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