NP – 327

V Semester B.Com. Examination, February/March 2024
(NEP) (Freshers)
COMMERCE
DSC 13 : Financial Management

Time : 2½ Hours | Max. Marks : 60

KEY ANSWER FOR FINANCIAL MANAGEMENT

PREPARED BY

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Instruction : *Answers should be written completely either in* ***English*** *or in* ***Kannada****.*

SECTION – A

Answer **any six** sub-questions. **Each** sub-question carries **two** marks. **(6×2=12)**

1.

a) Doubling time refers to the time period required to double the value or size of investment

b) Variable cost = Sales – Contribution = 8, 00,000-6, 00,000= 2, 00,000

c) NPV is to accept the project if the NPV is positive and reject the project if the NPV is NPV is negative.

d) 1.Nature of business, 2.Size of the business, 3.Market condition, 4.Volume of sale, 5.Cash requirement

e) Techniques to calculate time of money, Compounding and Discounting Techniques.

f) Wealth maximization is the concept of increasing a firm's worth to increase the value of stockholders' Shares. Wealth maximization is also known as net worth maximization

g) Financial mix refers to the composition of long term sources of funds such as equity shares, preference Shares, long term debts like debentures, long term loans, retained earnings etc.

h) $\frac{\text{Original Investment} - \text{Salvage Value}}{2}$+Additional Working Capital +Salvage Value

$\frac{20{,}000-3000(20{,}000X15\%)}{2}$ +2,000+3,000 = 8,500+2,000+3,000 =**13,500**

SECTION –B

Answer any three questions. Each question carries 4 marks

2. Explain the different methods of investment evaluation ?

I. ***Traditional method:***

A) Pay back period: PBP refers to the period in which the project will generate the necessary cash to recover the initial investment.

B) Accounting rate of return:ARR computes the average annual yield on the net investment in the project. It is computed by dividing the averages profit after depreciation and tax by investment of the project.

II..Discounted cash flow method:

C) Net present value: Net present value is a method of calculating present value of cash inflows and cash outflows in a investment project. BY using cost of capital as the discount rate and finding out NPV by subtracting present value of cash outflow from Present value of cash inflows.

D) **Internal rate of return:** Calculates the discount rate at which the Net Present Value (NPV) of future cash flows equals zero and thereby determines an investment's profitability.

E) **Profitability index:** Assesses the ratio of payoff to investment of a proposed project and addresses the problem of size disparity or scale inherent in the NPV model.

3. Scope of Financial Management

1. Capital Structure & Planning

In this scope of financial management, the professionals must create a plan for structuring this capital after forecasting the financial budget. They must first keep tabs on transactions and divide the available funds into various categories, such as the owner's risk capital, borrowed capital, and the short- and long-term debt-equity ratio.

2. Capital Budgeting

This scope of financial management involves predictions about all business transactions and operating expenses are the responsibility of the company's financial management executives. They produce a probable estimate of the fixed capital and working capital the company will need within a specific time period based on this estimate. The financial experts must also forecast any additional funds that the business might receive from investors. They consequently develop a budget for the distribution of those money. Learn how to become a financial analyst.

3.Financial Decision

Financial choices can be made with reference to a variety of funding sources, investments, and cash flow management. The company can obtain capital from a variety of sources, including shareholders, banks, public deposits, and other lenders. The financial management division examines each of these sources carefully and selects the one with the highest profit and lowest liability.

4. Working Capital Management

Another prominent decision that comes under the scope of Financial Management is working capital management. To determine the cash flow, financial executives first list the company's assets and liabilities. Short-term operational expenses and short-term liabilities are paid for with this cash flow. To manage working capital, the finance department examines a variety of ratios. They comprise the inventory ratio, the collection ratio, and the working capital ratio. The study's findings aid professionals in conducting efficient commercial operations.

5.Dividend Decision

The dividend decision is the essential scope of financial management. A financial manager's primary goal is to maximize shareholder value while contributing to the reputation of the organization. The choice to declare a dividend is fundamental to financial management. Dividends are payments made to shareholders and are determined using EPS.

6. Managing and Accessing risk

One of the essential processes that comes under the scope of Financial Management is managing and accessing risks. Risks frequently manifest themselves in unanticipated events or unanticipated market situations. Financial managers need to have a solid strategy in place to deal with these circumstances. Also, with the assistance of experts, they must anticipate potentially dangerous circumstances and make an effort to avoid them.

- Market risk
- Credit risk
- Liquidity risk

7. Operational risk

Many finance teams are not familiar with this large group. The likelihood of a cyberattack, the need for cybersecurity insurance, the existence of disaster recovery and business continuity plans, and the crisis management techniques to be applied in the event that a senior executive is accused of fraud or misconduct are some examples of the subjects it might cover.

8. Procedures

The procedure is the most essential scope of financial management. Financial data, including invoices, payments, and reports, are processed, and communicated by the finance department in accordance with policies established by the financial manager. Also, these written regulations outline who in the organization is in control of and authorizes financial decisions. For a variety of organization types, there are policy and procedure templates accessible, so businesses don't have to start from scratch.

4. FV= 10,000 $(1+1.25)^4$ +10,000$(1+0.125)^{4-1}$+10,000$(1+0.125)^{4-2}$10,000$(1+0.125)^{4-3}$

=10,000$(1.125)^4$+10,000$(1.125)^3$+10,000$(1.125)^2$+10,000$(1.125)^1$

= 10,000(1.602)+10,000(1.424)+10,000(1.266)+10,000(1.125)

= 16,020+14,240+12,660+11,250

FV=54,170

5. Calculations of Leverages

Particulars	₹
Sales	4,00,000
(-) Variable Cost @25% 4,00,000X25/100	1,00,000
Contribution	**3,00,000**
(-)Fixed Cost	75,000
EBIT	**2,25,000**
(-)Interest 50,000X15/100	7,500
EBT	**2,17,500**
(-)Tax 2,17,500X50/100	1,08,750
EAT	**1,08,750**

Operating leverage $=\frac{Contributin}{EBIT}= \frac{3,00,000}{2,25,000}$ **=1.33**

Financial Leverage $=\frac{EBIT}{EBT} = \frac{2,25,000}{2,17,500}$ **=1.03**

Combine Leverage= Operating leverage X Financial Leverage = 1.33X1.03 **= 1.369**

6. Advantages of Adequate working Capital

1. Solvency of the Business: Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.

2. Goodwill: Sufficient working capital enables a business concern to make prompt payments and hence helps in creating and maintaining goodwill.

3.Enhanced Operational Efficiency: Having enough working capital ensures that a business can smoothly run its day-to-day operations without disruptions. It enables timely payments to suppliers, employees, and creditors, fostering a sense of reliability.

4.Strategic Expansion: Sufficient working capital provides the financial firepower needed to explore growth opportunities. Whether it's opening new branches, launching new products, or expanding geographically, a strong working capital position supports strategic expansion.

5.Negotiating Power: Businesses with surplus working capital can negotiate better terms with suppliers and secure discounts for early payments, resulting in cost savings and improved profitability.

6.Debt Management: Maintaining adequate working capital allows a company to manage its short-term debts efficiently. It reduces the risk of default and ensures that interest and principal payments can be made on time.

SECTION –C

7. What are the characteristics/principles of sound financial planning?

1. **Simplicity :**A financial plan should be simple i.e. it should contain a simple financial structure that can be easily implemented and managed in short, the number of securities(the sources of funds) included in the financial plan should be less as possible.
2. **Long term view:**A financial plan should be formulated by considering both long term requirement and short term requirement of the concern. This is because a financial plan formulated would continue to operate for long term after the establishment of the concern
3. **Flexibility:**The financial plan should have flexibility i.e., the plan should be such that it can revised or changed according to changing needs of the business with minimum possible delay.
4. **Fore Sight:** Financial plan should be prepared by considering both present as well as future requirements of funds for the business, to assess the future requirements of funds, Future scope of operations, technological development, demand etc.
5. **Optimum Use:** The financial plan should provide for optimum use of funds, i.e., it should provide for the sufficient funds for meeting the needs of the business. A proper balance has to be maintained between long term short term funds.
6. **Contingencies:** A financial plan should make adequate provisions for funds for meeting the contingencies likely to arise in the future. It simply means the financial planner should forecast some contingencies which may arise and make provisions for funds for meeting future contingencies
7. **Liquidity:** There should be liquidity in the financial plan. Liquidity means the ability of concern to make available cash whenever required for making payments.
8. **Economy:** The plan should ensure economy. i.e., it should ensure that the cost raising funds is minimum. This is possible by having a proper mix between debt and equity in the capital structure of the concern.

9. **Profitability:** A financial plan should maintain the required proportion between fixed charges, obligations and the liabilities in such a way that the profitability is not affected adversely and it should be capable of earning cash inflow to meet various requirementsEconomy
10. **Uniformity:** Uniformity should be maintained while preparing financial plan. The sub plans and the main plans should have co-ordination while estimating the financial requirements, uniform techniques must be adopted in all plans.

8. **a) Sources of working capital**

1. Long term source

a. Equity share capital
b. Preference share capital
c. Debenture
d. Bonds
e. Long term loans

2. Short term source

a. Trade credit

3. Bank credit

a. Bank overdraft
b. Cash credit
c. Loans
d. Bills discount
e. Working capital term loan
f. Letter of credit

4. Commercial papers
5. Source factoring
6. Public deposits
7. Inter corporate loans / deposits
8. Other sources of working capital

- Retain profit
- Depreciation provision
- Deferral tax payment
- Accrued expenses

b) Functions of Finance manager

1. **Financial Forecasting:** Financial forecasting is the primary responsibility of financial management which states the adequate supply of cash. Funds are required continuously to a business at all stages for meeting both capital and revenue expenditure. So the finance manager should have an idea about the future requirements.

2. **Selecting of Right sources:** Financial manager should decide on the procurement of both short term and long term funds at right time and at right cost. A careful selection has to be made among equity capital, preference capital, borrowed loans and debentures.

3. **Allocation of funds:** Financial Manager should allocate capital to various investment proposals in order of their profitability. Each investment should yield full amount of return so as to attain the goal of wealth management.
4. **Analysis and appraisal of financial performance:** The finance manager should analyze the performance of each project in terms of profitability and returns. The finance manager can use ratio analysis and compare actual with standards to have efficient control over business unit.
5. **Cost volume profit analysis:** CVP analysis is another tool of the financial mgt that help the finance manager to evaluate different proposals of investments. Make or Buy decisions, Continuance or deletion of proposals decisions can be made. This helps the mgt to achieve long term objective of affirm.
6. **Working capital management:** Working capital is the life blood of business. Cash, bills receivable, debtors and inventory are the components of working capital. The finance manager should manage working capital in order to meet theirs day to day obligations of business.
7. **Capital Budgeting:** Capital budgeting technique helps the finance manager to evaluate investment proposals. The manager can use Pay back period, NPV ARR and IRR to understand the period of return and the rate of return.
8. **Profit planning and control:** Profit the excess of income over expenses. The finance manager should try to increase the profit through increased sales or cost reduction, break even analysis or CVP can be used in this purposes.
9. **Fair return to investors:** Returns are the profits to the investors. A fair return to the investors increases their confidence and encourages investment by people. A firm should ensure regular return to the share holders.
10. **Maintain Liquidity and wealth maximization:** Maintain Liquidity and wealth maximization is the primary objective of business firm. Liquidity helps the firm to meet its short term obligations towards creditors, bankers, employees, mgt etc. It increases the borrowing capacity of the firm and leads to growth of capital.

9. **Calculation of EPS**

Particulars	₹
Sales 20,00,000X5	1,00,00,000
(-) Variable Cost @30% 1,00,00,000X30/100	30,00,000
Contribution	**70,00,000**
(-)Fixed Cost	10,00,000
EBIT	**60,00,000**
(-)Interest 8,00,000X10/100	80,000
EBT	**59,20,000**
(-)Tax 5,92,00,000X50/100	29,60,000
EAT	**29,60,000**
(-)Preference Shares Dividend	**-------------**
EAESH	**29,60,000**
÷ No of Equity shares 6,00,000/10	**60,000**
EPS	**49.33**

Calculation if Level of EBIT of EPS is

a) EPS is ₹ 2

Particulars	₹
EBIT	**3,20,000**
(-)Interest 8,00,000X10/100	80,000
EBT	**2,40,000**
(-)Tax 5,92,00,000X50/100	1,20,000
EAT	**1,20,000**
(-)Preference Shares Dividend	**-------------**
EAESH	**1,20,000**
÷ No of Equity shares 6,00,000/10	**60,000**
EPS	**2**

b) EPS is ₹ 3

Particulars	₹
EBIT	**4,40,000**
(-)Interest 8,00,000X10/100	80,000
EBT	**3,60,000**
(-)Tax 5,92,00,000X50/100	1,80,000
EAT	**1,80,000**
(-)Preference Shares Dividend	**-------------**
EAESH	**1,80,000**
÷ No of Equity shares 6,00,000/10	**60,000**
EPS	**3**

c) EPS is 4

Particulars	₹
EBIT	**5,60,000**
(-)Interest 8,00,000X10/100	80,000
EBT	**4,80,000**
(-)Tax 5,92,00,000X50/100	2,40,000
EAT	**2,40,000**
(-)Preference Shares Dividend	**-------------**
EAESH	**2,40,000**
÷ No of Equity shares 6,00,000/10	**60,000**
EPS	**4**

d) EPS is 5

Particulars	₹
EBIT	**6,80,000**
(-)Interest 8,00,000X10/100	80,000
EBT	**6,00,000**
(-)Tax 5,92,00,000X50/100	3,00,000
EAT	**3,00,000**
(-)Preference Shares Dividend	**-------------**
EAESH	**3,00,000**
÷ No of Equity shares 6,00,000/10	**60,000**
EPS	**5**

10. Calculation of NPV

Machine A

Years	Cash Inflow (After Tax)	Depreciation(150000/5)	CIBD&AT	PVF	PVCI
1	45,000	30,000	75,000	0.909	68,175
2	60,000	30,000	90,000	0.826	74,340
3	75,000	30,000	1,05,000	0.750	78,750
4	45,000	30,000	75,000	0.683	51,225
5	30,000	30,000	60,000	0.621	37,260
				Total Present Value Cash inflow	**3,09,750**
				(-)Total Cash outflow	**1,50,000**
				NPV	**1,59,750**

Machine B

Years	Cash Inflow(After tax)	Depreciation(150000/5)	CIBD&AT	PVF	PVCI
1	15,000	30,000	45,000	0.909	40,905
2	45,000	30,000	75,000	0.826	61,950
3	60,000	30,000	90,000	0.750	67,500
4	90,000	30,000	1,20,000	0.683	81,960
5	90,000	30,000	1,20,000	0.621	74,520
				Total Present Value Cash inflow	**3,26,835**
				(-)Total Cash outflow	**1,50,000**
				NPV	**1,76,835**

11.Calculation of EPS

Particulars	Present	Plan-I	Plan-II	Plan-III	Plan-IV
Capital Structure					
Equity Shares of ₹ 10	3,00,00,000	3,00,00,000	3,00,00,000	3,00,00,000	3,00,00,000
Additional Capital					
10% Debenture	-------------	15,00,000	--------------	5,00,000	---------------
Equity shares	-------------	-----------------	15,00,000	10,00,000	5,00,000
10%,Preference Shares	-------------	------------------	-----------------	-----------------	10,00,000
Total Capital	3,00,00,000	**3,15,00,000**	**3,15,00,000**	**3,15,00,000**	**3,15,00,000**
EBIT	6,75,000	6,75,000	6,75,000	6,75,000	6,75,000
(-)Interest	--------	1,50,000	------------	50,000	----------
EBT	6,75,000	5,25,000	6,75,000	6,25,000	6,75,000
(-)Tax	3,37,500	2,62,500	3,37,500	3,12,500	3,37,500
EAT	3,37,500	2,62,500	3,37,500	3,12,500	3,37,500
(-)Preference Share Dividend	------------	----------------	------------------	-------------	1,00,000
EAESH	3,37,500	2,62,500	3,37,500	3,12,500	2,37,500
÷ No of Equity Shares	30,00,000	30,00,000	31,50,000	31,00,000	30,50,000
EPS	0.1125	0.0875	0.1071	0.1008	0.077