OR iii. Explain its significance of capital budgeting in the decision-making process of a firm. Also explain How does effective capital budgeting contribute to the overall success and profitability of a business? **8**

Q.6 Attempt any two:

i. What do you mean by working capital management? Explain its importance in reference of a successful business. **5**

ii. Differentiate between gross working capital and net working capital with suitable examples. **5**

iii. Explain the operating cycle concept and its significance in determining the working capital requirements of a business. **5**

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*Total No. of Questions: 6* *Total No. of Printed Pages:4*

**Enrollment No......................................**

# Faculty of Management Studies

## End Sem Examination May-2024

### MS3CO36 Financial Management

Programme: BBA Branch/Specialisation: Management / Business Analytics

**Duration: 3 Hrs.** **Maximum Marks: 60**

Note: All questions are compulsory. Internal choices, if any, are indicated. Answers of Q.1 (MCQs) should be written in full instead of only a, b, c or d. Assume suitable data if necessary. Notations and symbols have their usual meaning.

Q.1 i. Which of the following is NOT a financial decision? **1**

(a) Investment decision (b) Financing decision
(c) Production decision (d) Dividend decision

ii. If you invest $1000 at an annual interest rate of 5%, how much will you have in 5 years? **1**

(a) Rs. 1250.00 (b) Rs. 1276.28
(c) Rs. 1300.00 (d) Rs. 1500.00

iii. Which of the following is NOT a component of the cost of capital? **1**

(a) Cost of debt (b) Cost of equity
(c) Cost of goods sold (d) Cost of preference share capital

iv. What does the cost of capital represent for a company? **1**

(a) The cost of debt only
(b) The cost of equity only
(c) The combined cost of debt and equity
(d) The cost of retained earnings only

v. The optimal capital structure is the mix of debt and equity that _______. **1**

(a) Maximizes the cost of capital
(b) Minimizes the cost of capital
(c) Maximizes the risk
(d) Minimizes the risk

vi. Which of the following statements is true about financial leverage? **1**
(a) It increases the potential return to shareholders.
(b) It decreases the potential return to shareholders.
(c) It has no effect on the potential return to shareholders.
(d) It only affects the return on debt, not equity.

vii. Why is capital budgeting important for a business? **1**
(a) It helps in day-to-day financial planning
(b) It helps in maximizing short-term profits
(c) It helps in making long-term investment decisions
(d) It helps in managing operational expenses

viii. Which of the following capital budgeting techniques considers the time value of money? **1**
(a) Payback Period
(b) Internal Rate of Return (IRR)
(c) Accounting Rate of Return (ARR)
(d) Profitability Index (PI)

ix. Which of the following is not a component of working capital? **1**
(a) Cash (b) Inventory
(c) Long-term loans (d) Accounts receivable

x. The main objective of working capital management is to ensure: **1**
(a) Maximize long-term investments
(b) Minimize fixed assets
(c) Sufficient liquidity to meet short-term obligations
(d) Maximize shareholders' equity

Q.2 i. How finance is related with other disciplines? Explain. **4**

ii. Finance manager is not only interested in the procurement of funds but he is also concerned with all financial activities of the organization. In the light of this statement discuss the functions of a modern finance manager. **6**

OR iii. Calculate the present value from the following data: **6**
Amount of annuity is Rs. 50,000
Discount rate is 8%
Annuity duration is 5 years.

Q.3 i. What is cost of capital? **2**



ii. Calculate weighted average cost of capital from the following information: **8**

| **Source of Funds** | **Amount (Rs)** |
|---|---|
| 4000 Equity Shares (fully paid up) | 400000 |
| 3000 6% Debentures | 300000 |
| 2000 6% Preference Shares | 200000 |
| Retained Earnings | 100000 |

Earnings per equity share have been Rs. 10 during the past year and equity shares are being sold in the market at par. Assume corporate tax at 50% and shareholders personal tax liability 10%.

OR iii. Explain the various components of cost of capital and their significance in financial decision making. **8**

Q.4 i. How is EBIT calculated, and what does it represent in a company's income statement? **4**

ii. What do you understand by capital structure? Explain the various factors affecting capital structure. **6**

OR iii. The management of ABC Corp. wants to determine the company’s current degree of operating leverage. The company sells 10,000 product units at an average price of Rs. 50. The variable cost per unit is Rs. 12, while the total fixed costs are Rs. 100,000. **6**

Q.5 i. What is capital budgeting? **2**

ii. No project is acceptable unless yield is 10%. Cash inflows of a certain project along with cash outflows are given below: **8**

| **Year** | **Cash Outflows** | **Cash Inflows** | **P.V. Factor at 10%** |
|---|---|---|---|
| 0 | 1,50,000 | - | 1.000 |
| 1 | 30,000 | 20,000 | 0.909 |
| 2 | - | 30,000 | 0.826 |
| 3 | - | 60,000 | 0.751 |
| 4 | - | 80,000 | 0.683 |
| 5 | - | 30,000 | 0.621 |

The salvage value at the end of 5th year is Rs. 40000. Calculate the net present value of the project.

# Marking Scheme

MS3CO36 (T) Financial Management

| | | | |
|---|---|---|---|
| Q.1 | i) | C | **1** |
| | ii) | B | **1** |
| | iii) | C | **1** |
| | iv) | C | **1** |
| | v) | B | **1** |
| | vi) | A | **1** |
| | vii) | C | **1** |
| | viii) | B | **1** |
| | ix) | C | **1** |
| | x) | A | **1** |

Q.2 i. As per explanation. **3**

ii. 1 mark for each explained point. **7**

OR iii. **7**

**Solution:** $PVA_n = A\left[\frac{(1+r)^n-1}{r(1+r)^n}\right]$

where,

Present value of annuity which has duration of n years ($PVA_n$) = ?

Constant periodic flow (A) = ₹50,000

Discount rate (r) = 8%

No. of years for which discounting is done (n) = 5 years

$$PVAn = ₹50,000\left[\frac{(1+0.08)^5-1}{0.08(1+0.08)^5}\right]$$

$$= ₹\ 50,000\left[\frac{(1.08)^5-1}{0.08\ (1.08)^5}\right] = ₹50,000\left[\frac{1.4693-1}{0.08\times1.4693}\right]$$

$$= ₹\ 50,000\left[\frac{.4693}{.1175}\right] = ₹50,000[3.995] = ₹1,99,750$$

Q.3 i. As per explanation. **2**

ii. Working Note: **8**

Cost of Equity Capital: DPS/MP X 100 = 10/100 X 100 =10%

Cost of Retained Earning: Ke (1-tp) = 10% (1-.10) = 9%

Cost of Debentures: 6% (1-tc) = 6% (1 - .50) = 3%

Cost of Preference Share: = 6%

| Sources | Amount | Weights | After tax cost | Weighted Cost |
|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) = (3) x (4) |
| Equity Share Capital | 400000 | 0.4 | 0.1 | 0.04 |
| 6% Preference Share Capital | 200000 | 0.2 | 0.06 | 0.012 |
| 6% Debentures | 300000 | 0.3 | 0.03 | 0.009 |
| Retained Earnings | 100000 | 0.1 | 0.09 | 0.009 |
| **Weighted Average Cost of Capital** | | | | **0.07 or 7%** |

OR iii. 2 marks (Meaning) + 6 marks (1.5 marks for each Components and significance) **8**

Q.4 i. 1 mark (Meaning) + 2 marks (representation) **3**

ii. 2 marks (Meaning) + 5 marks for explanation **7**

OR iii. **7**

$$\text{Degree of Operating Leverage} = \frac{10{,}000 \times (\$50 - \$12)}{10{,}000 \times (\$50 - \$12) - \$100{,}000} = 1.38$$

The DOL indicates that every 1% change in the company's sales will change the company's operating income by 1.38%.

Q.5 i. Meaning or definition. **2**

ii. **Calculation of present value of cash outflow** **8**

| Year | Cash outflow (Rs) | PV factor at 10% | Cash Outflow (Rs) |
|---|---|---|---|
| 0 | 150000 | 1.00 | 150000 |
| 1 | 30000 | 0.909 | 27270 |
| **Present Value of Cash Outflow** | | | 177270 |

**Calculation of present value of cash Inflow:**

| Year | Cash inflow (Rs) | PV factor at 10% | Cash Inflow (Rs) |
|---|---|---|---|
| 1 | 20000 | 0.909 | 18180 |
| 2 | 30000 | 0.826 | 24780 |
| 3 | 60000 | 0.751 | 45060 |
| 4 | 80000 | 0.683 | 54640 |
| 5 | 30000 | 0.621 | 18630 |
| 5 | 40000 ***(Salvage value)*** | 0.621 | 24840 |
| | | | 186130 |

**Net Present Value:**

Total Present Value of Cash Inflow – Total Present Value of Cash Outflow

186130 – 177270 **= 8860 Rs.**

OR iii. 3 marks for (significance of capital budgeting) + 5 marks for (explanation) **8**

Q.6

i. 2 marks for (meaning) + 3 marks (importance) **5**

ii. As per the content. **5**

iii. 2 marks for (concept) + 3 marks for (significance) **5**

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