Capital Management – Interview Questions & Answers

Q: What is Capital Management?

A: Capital management refers to the process of planning, monitoring, and controlling a company's capital structure to ensure it maintains adequate liquidity, solvency, and profitability.

Q: What is Working Capital? How do you calculate it?

A: Working Capital = Current Assets - Current Liabilities. It measures a company’s short-term liquidity and operational efficiency. A positive working capital indicates that the company can meet its short-term obligations.

Q: What is the difference between Fixed Capital and Working Capital?

A: Fixed Capital is invested in long-term assets like land, building, machinery. Working Capital is used for day-to-day operations like paying wages, purchasing inventory, etc.

Q: What is Capital Structure?

A: Capital structure is the mix of debt and equity a company uses to finance its operations and growth. A well-balanced capital structure minimizes the cost of capital while maximizing shareholder value.

Q: What is WACC? Why is it important?

A: WACC (Weighted Average Cost of Capital) is the average rate a company is expected to pay to finance its assets, weighted by the proportion of debt and equity. It is used in investment decisions, capital budgeting, and valuation.

Q: How does leverage affect capital structure?

A: Leverage refers to the use of debt in the capital structure. Higher leverage can increase returns on equity in good times but also increases risk during downturns.

Q: What is ROCE and how is it useful?

A: ROCE (Return on Capital Employed) = EBIT / Capital Employed. It shows how efficiently a company uses its capital to generate profits.

Q: What factors influence a company's capital structure decision?

A: Cost of capital, cash flow stability, business risk, tax benefits, flexibility, market conditions, and company’s lifecycle stage.

Q: Explain the Trade-Off Theory of Capital Structure.

A: This theory suggests that firms balance the tax benefits of additional debt against the rising costs of financial distress to reach an optimal capital structure.

Q: What is the role of Capital Adequacy Ratio (CAR) in banks?

A: CAR = (Tier 1 + Tier 2 Capital) / Risk-Weighted Assets. It ensures that a bank has enough capital to absorb potential losses.

Q: How do you improve working capital?

A: Speed up receivables collection, delay payables without penalties, reduce inventory holding, tighten credit policy, and use just-in-time practices.

Q: Give an example of a poor capital structure decision and its impact.

A: Example: Jet Airways took on excessive debt during its expansion without sustainable revenue. As revenues declined, interest payments became unmanageable, leading to insolvency.

Q: How would you approach capital management during a financial crisis?

A: Preserve liquidity, renegotiate debt terms, delay capital expenditures, raise short-term funds, and prioritize core operations.

Q: Tell me about a time you identified inefficiency in capital use.

A: In my previous role, I noticed high inventory levels blocking working capital. I implemented demand forecasting and just-in-time inventory, reducing costs by 18%.

Q: You are CFO. Equity markets are down and interest rates are rising. Would you choose debt or equity for expansion?

A: I would be cautious with debt due to high interest costs and explore hybrid instruments or strategic partnerships over equity dilution or costly borrowing.