Short Answer Type Questions

1. What is meant by capital structure?
Ans: Capital structure refers to the mix between owners and borrowed funds. It represents the proportion of equity and debt.

$$\text{Capital Structure} = \frac{\text{Debt}}{\text{Equity}}$$

2. Discuss the two objectives of Financial Planning.
Ans: Financial Planning strives to achieve the following two objectives
(i) To Ensure Availability of Funds whenever These are Required This includes a proper estimation of the funds required for different purposes such as for the purchase of long term assets or to meet day-to-day expenses of business etc.
(ii) To See That the Firm Does Not Raise Resources Unnecessarily Excess funding is almost as bad as inadequate funding. Efficient financial planning ensures that funds are not raised unnecessarily in order to avoid unnecessary addition of cost.

3. What is 'financial risk? Why does it arise?
Ans: It refers to the risk of company not being able to cover its fixed financial costs. The higher level of risks are attached to higher degrees of financial leverage with the increase in fixed financial costs, the company its also required to raise its operating profit (EBIT) to meet financial charges. If the company can not cover these financial charges, it can be forced into liquidation.

4. Define a 'current assets' and give four examples.
Ans: Current assets are those assets of the business which can be converted into cash within a period of one year. Cash in hand or at bank, bills receivables, debtors, finished goods inventory are some of the examples of current assets.

5. Financial management is based on three broad financial decisions. What are these?
Ans: Financial management is concerned with the solution of three major issues relating to the financial operations of a firm corresponding to the three questions of investment, financing and dividend decision. In a financial context, it means the selection of best financing alternative or best investment alternative. The finance function therefore, is concerned with three broad decision which are as follows
(i) Investment Decision:
The investment decision relates to how the firm's funds are invested in different assets.
(ii) Financing Decision:
This decision is about the quantum of finance to be raised from various long term sources and short term sources. It involves identification of various available sources of finance.
(iii) Dividend Decision:
This decision relates to distribution of dividend. Dividend is that

portion of profit which is distributed to shareholders the decision involved here is how much of the profit earned by company is to be distributed to the shareholders and how much of it should be retained in the business for meeting investment requirements.

6. What is the main objective of financial management? Explain briefly.
Ans: Primary aim of financial management is to maximise shareholder's wealth, which is referred to as the wealth maximisation concept. The wealth of owners is reflected in the market value of shares, wealth maximisation means the maximisation of market price of shares.
According to the wealth maximisation objective, financial management must select those decisions which result in value addition, that is to say the benefits from a decision exceed the cost involved. Such value addition I increase the market value of the company's share and hence result in maximisation of the shareholder's wealth.

7. Discuss about working capital affecting both the liquidity as well as profitability of a business.
Ans: The working capital should neither be more nor less than ; required. Both these situations are harmful. If the amount of working capital is more than required, it will no doubt increase liquidity but decrease profitability. For instance, if large amount of cash is kept as working capital, i then this excessive cash will remain idle and cause the profitability to fall.
On the contrary, if the amount of cash and other current assets are very ' little, then lot of difficulties will have to be faced in meeting daily expenses and making payment to the creditors. Thus, optimum amount of both current assets and current liabilities should be determined so that profitability of the business remains intact and there is no fall in liquidity.

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