

Student Name :- ABC

Enrolment NO :- 12345678

Course Name :- Financial Management

Semester :- 3<sup>rd</sup>

Signature :- R

Program :- Master of Business Administration

Exam Date :- 11/1/24

Page NO :- 1 of 13

Q1

Financial management is concerned with not only the acquisition of funds but also with their efficient allocation. Modern financial management gives amicable solutions to resolve the financial issues of the organization. It focuses on the concept and suggest the total amount of funding that an organization requires. The three functions of financial management are as follows:-

i) Financial Decision:- The most important decision involved in the area of financial management is concerning the financing mix or capital structure or leverage of the firm. The financing decision addresses the question of where to arrange for the total funds of the firm and what shall be their proportion of debt and equity in the sources of finance, essential for investment in assets. There are two concepts that have to be focused on while taking a financing decision.

- Determining the right proportion of debt equity which is referred to as 'Capital structure decision'
- The relationship between the employment of debt and the return to shareholders - Commonly referred to as Capital structure theories.

ii) Investment Decisions:- The asset mix composition on which the firm shall be investing its amount is referred to as investment decision. The assets that the firm will acquire fall into two broad categories - long term referred to as capital budgeting decisions and short term as working capital management.

- Capital Budgeting:- Investments in assets whose benefits can be enjoyed for a long period of time in the future are referred to as long term assets. In most cases, capital budgeting decisions are irreversible and involve a lot of investment hence due diligence is required while making such investments. Three factors that have to be decided on during capital budgeting decisions: long term assets and their compositions, the risk associated with the operation of the asset, and measurement of cost of capital.
- Working Capital Management:- The day to day requirements of an organization form an integral part of financial management and this is referred to as working capital management. Working capital is associated with the composition of current assets and current liabilities of an organization. Striking the balance between profitability and liquidity is the core concept of working capital management.
- iii) Dividend policy Decision:- The final area of decision in financial management is with regard to the profits earned by the organization. The two alternatives available to organizations when they earn profits.
  - Either distribute the entire amount to the shareholders in the form of dividends.
  - Retain the amount in the organization for using it for business provisions.

Student Name: ABC

Enrolment No: 12345678

Signature : 2

Page No : 3 of 13

A2 Sol<sup>n</sup>

Particulars	6,000 units	<del>10,000</del> 9,000 units (+50%)
Sales @ 120/unit	7,20,000	10,80,000
Less: Variable cost @ 70	4,20,000	6,30,000
Contribution	3,00,000	4,50,000
Less:- Fixed cost	2,00,000	2,00,000
EBIT	1,00,000	2,50,000
$DOL = \frac{\text{Contribution}}{\text{EBIT}}$	3	1.8

A3 Long term sources of financing can be those that were raised with a sizable sum and have a repayment duration longer than five years. The category of financing includes share, capital, debenture issuance and long term loans from commercial banks and financial institutions. Long Term Sources of Finance includes.

- 1) Equity Shares:- Equity shares are also known as ordinary shares or common shares. The one who subscribes to these shares of the company, if receives the same from the company they will become equity shareholders.

### Advantages of Equity Shares

i) Permanent Source of Finance:- Equity share capital is a type of long term permanent source of funding and can be utilized to meet long term or fixed capital needs.

ii) Voting Rights:- Equity shareholders who are the true owners of the business are entitled to vote.

iii) Less Cost of Capital:- The cost of capital is a key element that influences a company's value.

### Disadvantages of Equity Shares

i) Irredeemable:- During the existence of the business concern equity shares cannot be redeemed. It's the riskiest aspect of overcapitalization.

ii) Leads to speculation:- When the economy is doing well equity share transactions on the stock market fuel speculation.

iii) Obstacles in management:- By organising themselves and engaging in manipulation, equity shareholders can create management barriers.

ii) Preference Shares:- When a firm makes a profit preference shareholders have priority over receiving dividends, and when a company is wound up preference shareholders capital is paid before any money is given to equity shareholders.

### Advantages of Preference Shares

i) Fixed Dividend:- For preference shares, the dividend percentage is fixed. Since it offers fixed rate of return.

ii) Redemption:- Preference shareholders with an exception of irredeemable preference share may be redeemed after a set time period. At the time of winding up preference shareholders are given preference over equity shareholders.

iii) Convertibility:- If permitted by the articles of organisation, convertible preference shares may be converted into equity shares.

### Disadvantages of Preference Shares

i) No Voting Rights:- Preference shareholders do not have any voting rights as a result they are unable to influence the company's decision.

ii) Expensive Source of Finance:- When compared to equity shares preference shares are much more expensive source of funding as they are entitled to receive fixed amount of dividend even if company is not in profitable position.

iii) Taxation:- The dividend on preference shares is not deductible as tax expense. However, interest is a tax-deductible cost.

Student Name :- ABC  
Enrolment No :- 12345678  
Signature :- 2  
Page No :- 5 of 13

iii) Debentures:- The issuance of debentures is one of the often used methods for a business to raise long term financing. The money raised through the issuance of debentures, which indicate debts assumed by the company, is referred to as debt capital. A debenture is a certificate with the company's common seal that certifies a debt owing to the certificate's holders.

### Advantages of Debentures

### Disadvantages of Debentures

i) Long Term Sources:- Debenture is one of the company's long term sources of funding. The maturity period is typically longer compared to other sources of funding.

i) Fixed Rate of Interest:- Debentures have fixed rates of interest that are due on securities. The set rate of interest must be paid to debenture holders even while the company is not making a profit.

ii) Income Tax deduction:- Interest paid on debentures may be subtracted from the company's overall profit. Consequently it aids in lowering the company's tax liability.

ii) No Voting Rights:- Holders of Debenture have no voting privileges. As a result, they are unable to influence operations of the company.

iii) Trade on Equity:- By include debentures in its capital structure a corporation can trade on equity and raise its earnings per share. When a corporation uses the concept of trade on equity, capital costs will go down and Company value will rise.

iii) High Risk:- Due to the increased expectations of debenture holders, every successive issuance of debentures increases the risk and expenses. Because of the elevated financial risk, raising money through debentures is also more expensive and has a high cost due to high Stamp duty.

Student Name:- ABC

Enrolment No:- 12345678

Signature :- P

Page No :- 6 of 13

24/ Sol<sup>n</sup>

i) Assued at Par:-  $P_0 = 100$   
 $f = 0.05$   
 $D_p = 100 \times 10\% = 10$

$$K_p = \frac{D_p}{P_0 (1-f)} \times 100$$
$$= \frac{10}{100(1-0.05)} \times 100$$
$$= \boxed{10.52\%}$$

ii) Assued at 5% Discount:-  $P_0 = 100 - (100 \times 5\%) = 95$   
 $f = 0.05$   
 $D_p = 100 \times 10\% = 10$

$$K_p = \frac{D_p}{P_0 (1-f)} \times 100$$
$$= \frac{10}{95(1-0.05)} \times 100$$
$$= \boxed{11.08\%}$$

iii) Assued at 10% premium:-  $P_0 = 100 + (100 \times 10\%) = 110$   
 $f = 0.05$   
 $D_p = 100 \times 10\% = 10$

$$K_p = \frac{D_p}{P_0 (1-f)} \times 100$$
$$= \frac{10}{110(1-0.05)} \times 100$$
$$= \boxed{9.56\%}$$

Student Name:- ABC

Enrolment No:- 12345678

Signature :- 

Page No :- 7 of 13

A5 Indian Financial system comprises of various markets, institutions, instruments, services and procedures that affect the creation of savings, investments, capital formation and ultimately the development of the country. The Indian financial system is composed of numerous distinct components and a structure that clearly indicates the rules and regulations are involved in keeping up with the investments and savings.

The components of Indian Financial system are as follows:-

- i) Financial Institutions:- Financial institutions are the intermediaries who facilitate smooth functioning of the financial system. They mobilize savings of the surplus units and allocate them in productive activities promising a better rate of return. Financial institutions are classified into two categories
  - A) Banking Institutions
  - B) Non-Banking Financial Institutions.
- ii) Financial Markets:- Financial markets refer to the institutional arrangements for dealing in financial assets and credit instruments of different types such as currency, cheques, bonds etc. Financial markets is categorized into two:-
  - A) Capital Market
  - B) Money Market

Student Name:- ABC

Enrolment No:- 12345678

Signature :- 

Page No : 8 of 13

iii) Financial Instruments:- Financial instruments refer to those documents which represents financial claims on assets. Financial assets refers to a claim to a claim to the repayment of a certain sum of money at the end of a specified period together with interest.

Examples:- Bills of exchange, Promissory note, Treasury bill financial instruments can be classified into two:-

a) Primary or Direct Securities

b) Secondary or Indirect Securities

iv) Financial Services:- Efficiency of emerging financial system largely depends upon the quality and variety of financial services provided by financial intermediaries. The term financial services can be defined as activities, benefits and satisfaction connected with the sale of money that offers to users and customers.



Student Name :- ABC

Enrolment No :- 12345678

Signature :- 

Page No :- 9 of 13

A6 The capital budget is the process of evaluating & selecting long-term investments that are consistent with the goal of shareholder's wealth maximization. Capital budgeting decision pertains to fixed and long term assets which by definition refer to assets which are in operation and yield a return over some time that exceeds one year.

Traditional methods of Capital Budgeting are as follows:-

i) Payback Period:- The payback method is a simple calculation that determines the length of time required to recover the initial investment in a project. This method is used to determine the liquidity of a project and is calculated as the total investment divided by the annual cash inflows. If the project generates constant cash inflows, the payback period can be computed by dividing cash outlay by the Annual cash inflow.

$$\text{PBP} =$$

$$\text{PBP} = \frac{\text{Investment}}{\text{Constant Cash Flow}}$$

ii) Accounting Rate of Return :- ARR is calculated as the average annual income generated by an investment divided by the average investment. This method is used to determine the profitability of an investment and is expressed as a percentage.

Student Name:- ABC

Enrolment No: 12345678

Signature : R

Page NO : 10 of 13

$$ARR = \frac{\text{Average Income}}{\text{Average Investment}} \times 100$$

The modern methods of Capital Budgeting ~~are~~ is mentioned below

i) Net Present Value:- NPV is widely used technique for long-term investments or assets. NPV recognizes the importance of the time value of money and calculates the discounted cash flow for different periods. The present value of cash inflow is compared with the present value of cash outflow. The difference between the cash inflow and outflow is referred to as NPV. The net present value method is a discounted cash flow analysis that calculates the present value of future cash flows and subtracts the initial investment to determine the potential return of an investment. If the NPV is positive the investment is expected to generate return and if the NPV is negative the investment is expected to result in loss.

ii) Profitability Index:- The profitability index is calculated as the present value of future cash flows divided by the initial investment. This method is used to determine the expected return of an investment and is expressed as a ratio

$$PI = \frac{\text{Present value of Cash Inflows}}{\text{Initial Cash outflow}}$$

If PI is greater than 1, the project is positive.

Student Name:- ABC

Enrolment No:- 12345678

Signature :- 

Page No : 11 of 13

iii) Internal Rate of Return:- The IRR is the discount rate at which the net present value of a project's cash flows is equal to zero. The IRR is used to determine the expected return on an investment and is expressed as a percentage. Project is accepted if its equal or more than cut off. IRR considers time value of money.

iv) Modified IRR:- MIRR is a modified version of the IRR that assumes that cash inflows are reinvested at a different rate than the discount rate used to calculate the NPV. This method is used to correct the potential inaccuracies in the IRR calculation and provide a more accurate representation of the expected return on investment.

Student Name: ABC

Enrolment No: 12345678

Signature : P

Page No :- 12 of 13

Q7

SOLD

i) Raw Material =  $\frac{1,00,000 \times 5 \times 2}{12} = 83,333.33$

ii) Work in Progress =  $\frac{1,00,000 \times 3.5 \times 1}{12} = 29,166.67$

iii) Finished goods =  $\frac{1,00,000 \times 7 \times 2}{12} = 1,16,666.67$

iv) Debtors =  $\frac{1,00,000 \times 7 \times 3}{12} = 17,500$

v) Creditors =  $\frac{1,00,000 \times 5 \times 2}{12} = 83,333.33$

vi) Wages =  $\frac{1,00,000 \times \frac{1 \times 1}{12}}{12} = 8,333.33$

vii) Overheads =  $\frac{1,00,000 \times \frac{1 \times 1}{12}}{12} = 8,333.33$

viii) Raw material - 5

Wages - 1

OH - 1

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Cost 7

Profit 3

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Selling Price 10

Student Name:- ABC  
Enrolment No:- 12345678  
Signature : 2  
Page No : 13 of 13

Particulars	Amt
<u>I CURRENT ASSETS</u>	
Raw material	83,333.33
Work In Progress	29,166.67
Finished goods	1,16,666.67
Debtors	1,75,000
Cash	50,000
<u>Total Current Assets (A)</u>	<u>4,54,166.67</u>
<u>II TO CURRENT LIABILITIES</u>	
Creditors	83,333.33
wages	8,333.33
Overheads	8,333.33
<u>Total Current Liabilities (B)</u>	<u>1,00,000</u>
<u>Working Cap (A-B)</u>	<u>354,166.67</u>

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