'समानो मन्त्रः समितिः समानी'

UNIVERSITY OF NORTH BENGAL

BBA Honours 3rd Semester Examination, 2023

CC7-BBA (303)

FINANCIAL MANAGEMENT

Time Allotted: 2 Hours | Full Marks: 60

The figures in the margin indicate full marks.

GROUP-A

Answer any *two* questions 12×2 = 24

1. (a) Why is it inappropriate to seek profit maximization as the goal of financial decision making? How would you justify the adoption of Wealth maximization as an apt substitute for it? 6+6

   (b) How does Gordon model differ from Walter's model of dividend decision? What are their similarities?

2. M/s Shivani and Co. has ₹2,00,000 to invest. The following proposals are under consideration. The cost of capital for the company is estimated to be 15 per cent. 6+6

Projects	Initial Outlay (₹)	Annual Cash Inflow (₹)	Life of Project (Years)
A	1,00,000	25,000	10
B	70,000	20,000	8
C	30,000	6,000	20
D	50,000	15,000	10
E	50,000	12,000	20

Rank the above projects based on Profitability Index. Given the investment target of ₹2,00,000, choose an optimum combination of the projects that can maximize the shareholders' wealth.

3. ABC Limited has a capital structure consisting of the following sources: 12

Sources of Capital	Amount (₹)
Equity Share of ₹100 each	20,00,000
Retained Earnings	10,00,000
9% Preference Shares	12,00,000
7% Debentures	8,00,000
Total	**50,00,000**

The company earns 12% on its capital employed. The income tax rate is 50%. The company requires a sum of ₹25 lakh to finance its expansion programme for which the company can tap only one of the following alternatives:

(i) Issue of 20,000 equity shares at a premium of ₹125 per share

(ii) Issue of 10% preference shares

(iii) Issue of 8% debentures.

It is estimated that the P/E ratios in the cases of equity, preference and debentures financing would be 21.4, 17.0, and 15.7 respectively. Which of the three financing alternatives would you recommend and why?

4. The board of directors of Nanak Engineering Company Enterprises requests you to prepare a statement showing the working capital requirements for a level of activity at 156,000 units of production. The following table shows the cost structure of producing each unit of the product: 12

Cost structure of Production

Elements of Costs	**Cost per unit (₹)**
Raw Materials	90
Direct Labour	40
Overheads	75
Total Cost	**205**
Profit	60
Selling price per unit	**265**

Additional Information:

(i) Raw materials are in stock, on average, for one month

(ii) Materials are in process (50% completion) on average for 4 weeks

(iii) Finished goods are in stock, on average, for one month

(iv) Credit allowed by suppliers is one month

(v) Time lag in payment from debtors is 2 months

(vi) Average lag in payment of wages is 1.5 months

(vii) Average lag in payment of overheads in one month

20% of the output is sold against cash. Cash in hand and in bank is expected to be ₹60,000. It is to be assumed that production is carried on evenly throughout the year, wages and overheads accrue similarly and a period of 4 weeks is equivalent to a month.

GROUP-B

5. Answer any ***four*** questions: 6×4 = 24

(a) Easter Retailers Inc is considering an investment proposal for the installation of new milling controls at a cost of ₹50,000. The facility has a life expectancy of 5 years and no salvage value. The tax rate is 35 percent. Assume the firm uses straight line depreciation and the same is followed for tax purposes. The estimated cash flows before depreciation and tax (CFBT) from the investment proposal are as under: 6

Year	1	2	3	4	5
CFBT(₹)	10,000	10,692	12,769	13,462	20,385

Compute the payback period of the investment proposal.

(b) Define 'cost of capital' and state its importance in financial management. 2+4

(c) Calculate the Degree of Operating Leverage (DOL), Degree of Financial Leverage (DFL) and the Degree of Combined Leverage (DCL) for the following firms and interpret the results: 6

		Firm-K	Firm-L	Firm-M
1.	Output (Units)	60,000	20,000	1,00,000
2.	Fixed costs (₹)	20,000	14,000	15,000
3.	Variable cost per unit(₹)	1.20	2.00	0.60
4.	Interest on borrowed funds (₹)	4,000	8,000	—
5.	Selling price per unit(₹)	2.60	5.00	1.20

(d) What do you understand by 'capital structure'? Explain the various factors affecting the capital structure decisions. 3+3

(e) What are the goals of financial management? Which goal is superior and why? 4+2

(f) Two firms, 'X' and 'Y' are identical in all respects except the degree of leverage. Firm 'X' has 8% debentures of ₹20,00,000. Operating profit of both firms is ₹6,00,000, and tax rate is 40%. Equity capitalization rate of 'Y' is 10%. Calculate value of each firm according to M-M approach. 6

GROUP-C

6. Answer any ***four*** questions: 3×4 = 12

(a) What do you mean by carrying cost of inventory?

(b) Explain the meaning of hedging, conservative and aggressive working capital policies.

(c) Explain importance of Capital Asset Pricing Model (CAPM).

(d) Explain the meaning and importance of '*Time Value of Money*'.

(e) What is '*Arbitrage*'? Explain with an example.

(f) What are the methods of paying dividends to the shareholders?

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