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Bachelor of Commerce 6th Semester

1048

FINANCIAL MANAGEMENT

Paper—BCM-602

Time Allowed : Three Hours]

[Maximum Marks : 80

Note :— (1) Attempt **four** short answer type questions from Section A. Attempt **two** questions each from Section B and Section C respectively.

(2) Each question in Section A carries 5 marks.

(3) Each question in Sections B and C carries 15 marks.

SECTION—A

I. Attempt the following :

- (a) "Investment, financing and dividend decisions are all inter-related." Give short comment on this statement.
- (b) At the time of his retirement Mr. A is given a choice between two alternatives : (i) An annual pension of Rs. 10,000 as long as he lives, and (ii) a lump sum payment of Rs. 60,000. If Mr. A expects to live for 15 years and rate of interest is 15% which alternative should be selected ?
- (c) What is lease financing ? Give its types.
- (d) Enlist the factors that influence the dividend policy of a firm.

- (e) A 5 year Rs. 100 debenture of a firm can be sold for a net price of Rs. 96.50. The coupon rate of interest is 14% p.a. and the debenture will be redeemed at 5% p.a. premium on maturity. The firm's tax rate is 40 percent. Compute the after tax cost of debenture.
- (f) The capital structure of the Progressive Corporation Ltd. consists of an equity share capital of Rs. 10,00,000 (share of Rs. 10 par value) and Rs. 10,00,000 of 20% debentures sales increased by 25% from 2,00,000 units to 2,50,000 units, the selling price is Rs. 10 per unit, variable costs amount to Rs. 6 per unit and fixed expenses amount to Rs. 2,50,000. (Income Tax Rate = 50%).

You are required to calculate :

- (i) The percentage increase in Earning per share.
 - (ii) The degree of financial leverage at 2,00,000 units and 2,50,000 units.
 - (iii) The degree of operating leverage at 2,00,000 units and 2,50,000 units.
- $4 \times 5 = 20$

SECTION—B

- II. Give comparative description of various methods of ranking investment proposals.
- III. What do you mean by Financial Management ? What is the scope of finance function in a business enterprise ? Should the goal of financial decision-making be profit maximisation or wealth maximisation ?

IV. A bulldozer which has a service life of 10 years can be purchased for Rs. 1,80,000. It can also be hired at the rate of Rs. 45,000 per annum payable at the beginning of each year. Operating costs are to be borne by the user.

A contractor, requiring the use of the bulldozer only for a period of two years seeks your advice.

If purchased, he expects to use it for 2 years and then sell it at 80 per cent of the purchase price. He can finance its purchase by own resources to the extent of Rs. 80,000 and the balance by borrowing at an interest rate of 18 per cent per annum. The interest on loan is payable annually at the end of each year and the loan can be repaid out of the sale proceeds of the bulldozer. For Income Tax purposes, depreciation is an admissible deduction at 25 per cent on diminishing balance method. Excess realisation, if any, over the written down value is subject to tax. The effective rate of tax for the contractor is 50%. Tax liabilities can be assumed to rise at the end of each year.

The contractor expects a minimum internal rate of 10% net of taxes on his own funds. Prepare a suitable statement and advise the contractor indicating clearly the basis for your recommendations.

V. The following is the capital structure of a company :

Source of Capital	Book Value	Market Value
Equity shares @ Rs. 100 each	8,00,000	16,00,000
9% cumulative Preference shares @ Rs. 100 each	2,00,000	2,40,000
11% Debentures	6,00,000	6,60,000
Retained earnings	4,00,000	—
	20,00,000	25,00,000

The current market price of the company's Equity Share is Rs. 200. For the last year the company had paid equity dividend at 25 per cent and its dividend is likely to grow 5 per cent every year. The Corporate Tax rate is 30 per cent and Shareholders Personal Income Tax is 20 per cent.

You are required to calculate :

- Cost of Capital for each source of Capital.
- Weighted average cost of capital on the basis of book value weights.
- Weighted average cost of capital on the basis of market value weights.

$$15 \times 2 = 30$$

SECTION—C

- VI. Explain theories of Capital Structure using imaginary figures.
- VII. "Debentures occupy a very important place in the financial plan."
Discuss the statement and point out the limitations of debenture financing.
- VIII. A Proforma Cost Sheet of a company provides the following particulars :

Elements of cost :

Material	40%
Direct Labour	20%
Overheads	20%

The following further particulars are available :

- (a) It is proposed to maintain a level of activity of 2,00,000 units.
- (b) Selling price is Rs. 12 per unit.
- (c) Raw Materials are expected to remain in stores for an average period of one month.
- (d) Material will be in process, on average half a month and is assumed to be consisting of 100% raw material, wages and overheads.

- (e) Finished goods are required to be in stock for an average period of one month.
- (f) Credit allowed to debtors is two months.
- (g) Credit allowed by supplier is one month.

You may assume that sales and production follow a consistent pattern.

You are required to prepare a statement of working capital requirements, a forecast Profit and Loss Account and Balance Sheet of the company assuming that :

	Rs.
Share Capital	15,00,000
8% Debentures	2,00,000
Fixed Assets	13,00,000

IX. The following information is available in respect of the rate of return (r) on investment, cost of capital (K) and earning per share (E) of ABC Ltd.

Rate of return on investment (r) = (i) 15%, (ii) 12% and (iii) 10%

Cost of Capital (K) = 12%

Earning per share (E) = Rs. 10

Determine the value of its shares using Gordon's Model assuming the following :

	D/p Ratio (1-b)	Retention Ratio (b)
(a)	100	0
(b)	80	20
(c)	40	60

$$15 \times 2 = 30$$