2018

M.Com.

2nd Semester Examination

FINANCIAL MANAGEMENT AND POLICY

PAPER—COM-201

Subject Code—03

Full Marks : 50

Time : 2 Hours

The figures in the right-hand margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

Illustrate the answers wherever necessary.

Unit – I

(Marks : 20)

1. Answer any *two* questions : 2×5

(a) Explain the term 'Shareholders value creation'.

(b) Show that

$$\text{Degree of Financial Leverage (DFL)} = \frac{\text{EBIT}(1-t)}{\text{EBT}(1-t)-p}$$

(Turn Over)

Where EBIT = Earning Before Interest and Tax

t = Taxrate

EBT = Earning Before Tax

P = Preference Dividend.

(c) (i) Explain the statement that operating risk can not be completely avoidable but financial risk can be completely avoidable.

(ii) The finance Manager of a company has formulated different financial plans to finance Rs. 30,00,000 required to implement various capital budgeting projects.

Either equity share capital of ₹ 20,00,000 and 10% debentures of ₹ 10,00,000 or, 13% preference capital of ₹ 10,00,000, 10% debentures of ₹ 8,00,000 and ₹ 12,00,000 equity.

You are required to determine the indifference point of the above financial plan, assuming 35% tax rate and face value of equity shares of ₹ 100. 2+3

(d) (i) Distinguish between explicit cost of capital and implicit cost of capital.

(ii) Do you think that market value weight is more appropriate in overall cost of capital calculation that book value weight ? 2+3

2. Answer any *one* question : 1×10

(a) Nandita Ltd. has at present a share capital of ₹ 60 lakhs divided into 60,000 equity shares of ₹ 100 each. The management of the company has taken up an expansion plan for which the company requires an additional sum of ₹ 30 lakhs. The possible alternative sources of finance for the company for this additional amount are as under.

(i) Entirely through new equity issue of ₹ 100 each ;

(ii) ₹15 lakhs by the issue of new equities of ₹100 each and balance by the issue of 10% debentures at par.

(iii) ₹ 10 lakhs by the issue of 10% debentures and the balance by the issue of 8% cumulative preference shares.

The present level of output of the company is 2 lakh units which it can sell in the market @ ₹ 25 each.

The variable cost of the output per unit is ₹ 10 and the total fixed cost is ₹ 12 lakhs.

The company anticipates that if it can successfully implement this expansion programme, its production will increase by 20% wlhich it can sell in the market.

Assuming that the comapny is currently operating in the 50% tax bracket, which one of the above three alternative schemes of financing will you recommend for the firm with reference to risk content in it ?

10

(b) (i) Write the significance of cost of capital in financial management.

(ii) Aman Ltd. has assets of ₹ 15,00,000 which have been financed by ₹ 4,00,000 of 10% Debentures, ₹ 1,00,000 of 8% Preference, ₹ 2,00,000 of General Reserve and remaining ₹ 8,00,000 of equity shares (₹ 100 each share).

The firm's EBIT for the year ended 31-3-2018 is ₹ 3,76,000. The current market price of each debenture is ₹ 105, each Preference shares ₹ 140 and each equity share is ₹ 180.

Compute weighted average cost of Capital using market values as weights. Assume the corporate tax rate is 50%. 2+8

Unit – II

(Marks : 20)

3. Answer any *two* questions : 2×5

(a) Distinguish between aggressive approach and conservative approach of working capital financing.

(b) Why should government facilitate the working capital financing to the corporate sector ?

(c) What is objective of cash management ? What are the motives behind holding cash ?

(d) Find out valuation of the company under Walter Model if

(1) rate of dividend in 10% on face value. (2) rate of dividend in 30% on face value, on the basis of information below :

(i) Profit before Indent and Tax = ₹ 120 Cr.

(ii) Tax rate in 40%.

(iii) No. of Shares 10 Cr. of Rs. 10 each.

(iv) 8% Debentures Rs. 250 Cr.

(v) The shareholders expect 12% return on their investment.

(vi) Capital Employed ₹ 400 Cr.

State with reason which dividend option would be preferable for the company. 2+2+1

4. Answer any *one* question : 1×10

(b) (i) From the following data compute duration of operating cycle :

	Year 1	*Year 2*
Stock :	₹	₹
Raw Materials	20,000	27,000
Work-in-progress	14,000	18,000
Finished goods	21,000	24,000
Purchases	96,000	1,35,000
Cost of goods sold	1,40,000	1,80,000
Sales	1,60,000	2,00,000
Debtor	32,000	50,000
Creditors	16,000	18,000

[Assume 350 days per year for computational purposes]

Comment on the change in duration of operating cycle.

(ii) Discuss the concept of operating cycle with its significance. (5+2)+3

(b) (i) Two similar companies are adopting different dividend policies. A company has adopted regular but consumative dividend policy where as other company has adopted Liberal dividend policy with erratic fluctuation. Compare the dividend policies and offer your comment.

(ii) Discuss how economic condition and shareholder's expectation affect dividend policy of a company.

(iii) What are the different types of dividend policy ? Write at least a sentence on each of them.

3+(2½×2)+2

[Internal Assessment — 10 Marks]

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