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**Y 1611**

M.B.A. DEGREE EXAMINATION, AUGUST/SEPTEMBER 2008.

Second Semester

DBA 1654 — FINANCIAL MANAGEMENT

Time : Three hours

Maximum : 100 marks

Answer ALL questions.

PART A — (10 × 2 = 20 marks)

1. Define financial management.
2. What is an option?
3. What is an IRR?
4. What is overall cost of capital?
5. What is financial leverage?
6. What is financial distress?
7. Explain the gross and net working capital concepts.
8. What is commercial paper?
9. What is hire purchase?
10. What is venture capital?

PART B — (5 × 16 = 80 marks)

11. (a) (i) What are the basic financial decisions? How do they involve risk-return trade-off? (10)
- (ii) What functions do the financial officer perform? (6)

Or

- (b) (i) A company expects to pay a dividend of Rs.7 next year that is expected to grow at 6%. It retains 30% of earnings. Assume a capitalization rate of 10%. You are required to
- (1) Calculate the expected earnings per share next year (EPS),
  - (2) Return on equity (ROE) and
  - (3) The value of growth opportunities. (2 + 2 + 4 = 8)
- (ii) Your father promised to give you Rs. 1,00,000 in cash on your 25th birthday. Today is your 16th birthday. He wants to know two things:
- (1) If he decides to make annual payments into a fund after one year, how much will each have to be if the fund pays 8%?
  - (2) If he decides to invest a lump sum in the account after one year and let it compound annually, how much will the lump sum be?
  - (3) If in (a) the payments are made in the beginning of the year, how much will be the value of annuity? (2 + 3 + 3 = 8)
12. (a) (i) Define cost of capital? Explain its significance in financial decision making. How is weighted average cost of capital calculated? (8)
- (ii) Define capital rationing. What are its types? How would you select the investment projects under one-period capital constraint? Would capital rationing lead to sub-optimal investment decision? (8)

Or

- (b) A company is considering the following investment projects:

		Cash flows (Rs.)			
Projects		C0	C1	C2	C3
A		-10,000	+10,000		
B		-10,000	+7,500	+7,500	
C		-10,000	+2,000	+4,000	+12,000
D		-10,000	+10,000	+3,000	+3,000

Rank the project according to each of the following methods:

- (i) Payback
- (ii) ARR ;
- (iii) IRR and
- (iv) NPV, assuming discount rates of 10%. (2 + 2 + 8 + 4 = 16)

PV Factor	Year 1	Year 2	Year 3
10%	.909	.826	.751

13. (a) Explain the nature of factors which influence the dividend policy of a firm. (16)

Or

- (b) A company needs Rs. 5,00,000 for construction of a new plant. The following three financial plans are feasible:

- (i) The company may issue 50,000 ordinary shares at Rs. 10 per share.
- (ii) The company may issue 25,000 ordinary shares at Rs. 10 per share and 2,500 debentures of Rs. 100 denominations bearing a 8% rate of interest.
- (iii) The company may issue 25,000 ordinary shares at Rs.10 per share and 2,500 preference shares at Rs. 100 per share bearing a 8 per cent rate of dividend.

If the company's earnings before interest and taxes are Rs. 10,000, Rs. 20,000, Rs. 40,000, Rs. 60,000 and Rs. 1,00,000, what are the earnings per share under each of the three financial plans? Which alternative would you recommend and why? Assume corporate tax rate of 50%. (16)

14. (a) Explain the objectives of credit policy? What is an optimum credit policy? Discuss. (16)

Or

- (b) The performa cost sheet of a company provides the following data:

	Rs.
Cost per Unit :	
Raw materials	52.0
Direct labour	19.5
Overheads	39.0
Total cost per unit	110.5
Profit	19.5
Selling price	130.0

The following is the additional information available:

Average raw material in stock: one month; average materials in process: half a month. Credit allowed by suppliers: one month; Credit period allowed to debtors: two months. Time lag in payment of wages: one and a half weeks.

Overheads: one month. One-fourth of sales are on cash basis. Cash balance is expected to be Rs. 1,20,000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly. (16)

15. (a) (i) Explain the concept of the capital market efficiency. What are the different forms of capital market efficiency? (8)
- (ii) Explain the role of merchant banking in capital markets. (8)

Or

- (b) (i) What is project financing? Explain the financing arrangements available for infrastructure projects? (8)
- (ii) What are the cash flow consequences of a Financial Lease? Explain the two methods used for evaluating leasing. (8)