

**M.B.A. DEGREE EXAMINATIONS: NOVEMBER 2009**

Third Trimester

**P07BA202: FINANCIAL MANAGEMENT****Time: Three Hours****Maximum Marks: 100****Answer ALL the Questions:-****PART A (1 x 20 = 20 Marks)****1. Case Study:-**

Mr. Rao, Finance Director of Modern Synthetics Limited, called Mr. Diwan, manager, management Service Division of the company to explore ways and means of improving the management information system in the company. On the basis of their discussion it became obvious that the company needed a computer system for processing efficiently and accurately the growing volume of information generated in the business. It was felt that the computer system would also facilitate the timely preparation of control reports needed by the management.

Mr. Rao asked Mr. Diwan to find out which computer system would be suitable for the needs of the company and estimate the costs and benefits expected from it. Mr. Diwan talked to the representatives of a few computer manufacturing companies. On the basis of his discussion with them he felt that the Alpha III system supplied by Computronics Limited was quite suitable for the needs of Moderns Syntax Limited. He estimated the costs and benefits associated with this system as follows.

• Cost of the computer along with accessories	Rs. 15 lakh
• Operation and maintenance cost	Rs. 2.5 lakh p.a.
• Savings in clerical cost	Rs. 6 lakh p.a.
• Savings in space cost	Rs. 2 lakh p.a.

The computer would have an economic life of five years and it would be depreciated at the rate of  $33 \frac{1}{3}$  percent per year as per the written down value method. After five years, it would be disposed of for a value equal to its book value.

On examining the above information, Mr. Gupta asked Mr. Diwan to prepare a capital budgeting proposal for submission to the Executive Committee of the company. He advised him to work out the internal rate of return.

**PART B (10 x 2 = 20 Marks)**

2. What is the primary economic principle used in managerial finance?
3. How is the finance function organized in a large company?

4. What is capital budgeting?
5. What are the weaknesses of the payback period method?
6. What is meant by financial leverage?
7. Define bonus share.
8. What are the components of current assets?
9. What is meant by Trade credit?
10. What is meant by venture capital financing?
11. Define Hire purchase.

**PART C (4 x 15 = 60 Marks)**

12. (a) Explain the concept of valuation of securities? Why is the valuation concept relevant for financial decision-making purposes?

**(OR)**

- (b) A company expects to pay a dividend of Rs. 7 next year that is expected to grow at 10 per cent. It retains 30 per cent of earnings. Assume a capitalization rate of 10 per cent. 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.

13. (a) Assuming that the firm pays tax at a 50 percent rate, compute the after – tax cost of capital in the following cases:

- (1) A 8.5 percent preference share sold at par.
- (2) A perpetual bond sold at par, coupon rate of interest being 7 percent.
- (3) A ten-year, 8 percent, Rs. 1000 par bond sold at Rs. 950 less 4 percent underwriting commission.
- (4) A preference share sold at Rs. 100 with a 9 percent dividend and a redemption price of Rs. 110 if the company redeems it in five years.
- (5) An ordinary share selling at a current market price of Rs. 120, and paying current dividend of Rs. 9 per share, with is expected to grow at a rate of 10 percent.
- (6) An ordinary share of a company, which engages no external financing, is selling for Rs. 50. The earnings per share are Rs. 7.50 of which sixty per cent is paid in dividends. The company reinvests retained earnings at a rate of 10 percent.

**(OR)**

(b) Describe the Modigliani -Miller approach to the irrelevance of dividend and evaluate its validity?

14. (a) Explain the factors that determine the working capital needs of a firm.

(OR)

(b) X & Co. is desirous to purchase a business and has consulted you, and on e point on which you are asked to advise them is the average amount of working capital which capital will be required in the first year's working. You are given the following estimates and are instructed to add 10 per cent to your computed figure to allow for contingencies:

Figures of the year Rs.		
Average amount backed up for stocks:		
Stocks of finished product		5,000
Stocks of stores, materials, etc.		8,000
Average credit given:		
Inland sales	6 week's credit	3,12,000
Export sales	1½ weeks' credit	78,000
Lag in payment of wages and other outgoing:		
Wages	1 ½ weeks	2,60,000
Stocks, materials, etc.	1 ½ weeks	48,000
Rent, royalties, etc.	6 months	10,000
Clerical staff	½ month	62,000
Manager	½ month	4,800
Miscellaneous expenses	1 ½ months	48,000
Payment in advance:		
Sundry expenses (paid quarterly in advance)		8,100
Undrawn profits on the average throughout the year		11,000

15. (a) What is the difference between Primary market and Secondary market? Describe some significant development in the Indian stock markets.

(OR)

(b) What are the steps involved in a venture capital investment process? Explain them.

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