2019/EVEN/10/29/MBACC–208/009

PG Even Semester (CBCS) Exam., April—2019

BUSINESS ADMINISTRATION

(2nd Semester)

Course No. : MBACC–208

(Financial Management)

Full Marks : 70
Pass Marks : 28

Time : 3 hours

The figures in the margin indicate full marks for the questions

1. *(a)* "Financial management is something more than an art of Accounting and Book-keeping." Explain. 4

(b) Why is it inappropriate to seek profit maximization as the goal of financial decision-making? 5

(c) How would you justify the adoption of present value maximization as an option for an organization? 5

2. *(a)* "An important financial principle is that the value of money is time dependent." Explain the statement in the light of principles determining the time value of money. 5

(b) Deepak Kumar is 63 years old and recently retired. He wishes to provide retirement income for himself and is considering an annuity contract with the Global Life Insurance Company. Such a contract pays him an equal rupee amount each year that he lives for this cash-flow stream, he must put up a specific amount of money at the beginning. According to actuary tables, his life expectancy is 15 years, and that is the duration on which the insurance company bases its calculations regardless of how long he actually lives.

(i) If global life uses a compound annual interest rate of 5 percent in its calculations, what must Mr. Kumar pay at the out set for an annuity to provide him with ₹ 10,000 per year? (Assume that the expected annual payments are at the end of each of the 15 years.)

(ii) What would be the purchase price if the compound annual interest rate is 10 percent?

(iii) Mr. Kumar had ₹ 30,000 to put into an annuity. How much would he receive each year if the insurance company uses a 5 percent compound annual interest rate in its calculations and a 10 percent compound annual interest rate?

3+3+3=9

OR

3. *(a)* "The effect of a price increase is always to increase the P/V ratio, to bring down the break-even point and to widen the margin of safety." Discuss. 4

(b) The New Age Pharmaceuticals Ltd.'s income statement for the preceding year is presented below. Except as noted, the cost/revenue relationship for the coming year is expected to follow the same pattern as in the preceding year.

Income statement for the year ending March 31 is as follows :

	(₹)	(₹)
Sales (2000000 bottles @ 25 paise each)		5,00,000
Variable costs	3,00,000	
Fixed costs	1,00,000	4,00,000
Pre-tax profit		1,00,000
Less : Taxes		35,000
Profit after tax		65,000

(i) What is the break-even point in amount and units?

(ii) Suppose that a plant expansion will add ₹ 50,000 to fixed costs and increase capacity by 60 percent. How many bottles would have to be sold after the addition to break-even?

(iii) At what level of sales will the company be able to maintain its present pre-tax profit position even after expansion?

(iv) The company's management feels that it should earn at least ₹ 10,000 (pre-tax per annum) on the new investment. What sales volume is required to enable the company to

maintain existing profits and earn the minimum required return on new investments?

(v) Suppose the plant operates at full capacity after the expansion. What profit will be earned? 2×5=10

4. *(a)* Suppose that a firm finances its seasonal (temporary) current assets with long-term funds. What is the impact of this decision on the profitability and risk of this firm? 4

(b) Reliance Industries has a seasonal pattern to its business.It borrows under a line of credit from Union Bank at 1 percent over prime. Its total assets requirements now (at year end) and estimated requirements for the coming year are (₹ in lakhs) as follows :

	Now	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Total Asset requirements	45	48	55	59	50

Assume that these requirements are level throughout the quarter. At present, the company has ₹ 45 lakhs in equity capital plus long-term debt plus the permanent component of current liabilities, and this amount will remain constant throughout the year.

The prime rate currently is 11 percent, and the company expects no change in this rate for the next year. Reliance Industries is also considering issuing intermediate term debt at an interest rate of 13·5 percent. In this regard, three alternative amounts are under consideration : zero, ₹ 5,00,000 and ₹ 10,00,000. All additional funds requirements will be borrowed under the company's bank line of credit.

(i) Determine the total borrowing cost for short and intermediate term debt under each of the three alternatives for the coming year. (Assume that there are no changes in current liabilities other than borrowings.) Which alternative is lowest in cost?

(ii) Is there a consideration other than expected cost that deserves your attention? 5×2=10

OR

5. *(a)* What are the three motives of holding cash? Explain. 4

(b) Aditya Birla Group has 41 clothing outlets scattered throughout the country. Each outlet sends an average of ₹ 5,000 daily to the Head Office in Mumbai through cheques drawn on local banks. On average its takes six days before the company's Mumbai bank collects the cheques. The firm is considering an electronic funds transfer arrangement that would completely eliminate the float.

(i) What amount of funds will be released?

(ii) What amount will be released on an interest basis if each local bank requires an increase in compensating balances of ₹ 15,000 to offset the loss of float?

(iii) Suppose the company could earn 10 percent interest on the net released funds in part (ii). If the cost per electronic transfer was ₹ 7 and each store averaged 250 transfers per year, would the proposed arrangements be worth-while? (Assume that the cost of issuing checks on local banks is negligible.) 10

6. *(a)* Do the profitability index and the NPV criterion of evaluating investment proposals lead to the same acceptance/ rejection and ranking decisions? In what situations will they give conflicting results? 2×2=4

(b) A company has to select one of the following two projects :

Particulars	*Project A* (₹)	*Project B* (₹)
Initial investment	11,000	10,000
Cash inflows :		
Year 1	6,000	1,000
" 2	2,000	1,000
" 3	1,000	2,000
" 4	5,000	10,000

Using the internal rate of return method, suggest which project is preferable. 10

OR

7. *(a)* "Cost of capital is the sum of the minimum rate of return at zero risk level plus a premium for a business risk plus a premium for financial risk." Explain. 4

(b) Bajaj Industries issued 10000 equity shares of ₹ 10 each at a premium of ₹ 2 each. The company has incurred issue

expenses of ₹ 5,000. The equity shareholder expects the rate of dividend to 18% p.a. Calculate the cost of equity share capital. Will your answer be different if the current market price of share is ₹ 21? 5×2=10

8. *(a)* Critically examine the 'net income and net operating income approaches' to capital structure. 7

(b) *NE* Ltd. earned a profit of ₹ 20 lakhs before providing for interest and tax. The company's capital structure is as follows :

(i) 400000 equity shares of ₹ 10 each and its market capitalization rate is 16%

(ii) 25000, 14% secured redeemable debenture of ₹ 150 each

You are required to calculate the value of the firm under 'net income approach'. Also calculate the overall cost of capital of the firm. 3½×2=7

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