Total number of printed pages–5

2014

FINANCIAL MANAGEMENT

Paper : 4·3

Full Marks : 80

Time : Three hours

The figures in the margin indicate full marks for the questions.

1. Fill in the blanks with appropriate words : 1×5=5

(a) A fixed rate of ________ is payable on debentures.

(b) Degree of operating leverage = ________

(c) It is better for a company to remain in ________ gear during the period of depression.

(d) Issue of bonus share is a remedial measure for ________.

(e) Cost of capital is the ________ rate of return expected by its investors.

2. State whether the following statements are true or false : 1×5=5

(a) The issue of bonus shares amounts to a corresponding increase in the paid-up capital of the company.

(b) Increased use of debt increases the financial risk of equity shareholders.

(c) Traditional approach confines finance function only to raising of funds.

(d) According to Walter's model, dividend decision affects the value of the firm.

(e) Ownership securities are represented by debentures.

3. Answer the following : ***(maximum fifty words)*** 2×5=10

(a) What is finance function ?

(b) State *any two* causes of over capitalisation.

(c) How is capitalisation calculated on the basis of 'Cost Theory' ?

(d) What is composite leverage ?

(e) Why is preferred stock also termed as 'hybrid security' ?

4. Answer the following : ***(any five)*** 4×5=20

(a) Write a short note on the importance of capital-gearing and dividend pay-out ratio. 2+2=4

(b) What is optimal capital structure ? Explain.

(c) How is cost of retained earnings ascertained ?

(d) State *four* differences between shares and debentures.

(e) Explain *any two* types of dividend policy. 2+2=4

(f) A firm has sales of ₹ 15,00,000, variable costs of ₹ 8,00,000 and fixed costs of ₹ 5,00,000. It issues debentures of ₹ 8,00,000 carrying 10% rate of interest. Calculate

(a) Operating leverage and

(b) Financial leverage.

(g) How does financial leverage help in maximising the profits of a firm ?

5. Answer the following : ***(any five)*** 8×5=40

(a) 'The consequences of over capitalisation are far more serious than under capitalisation'. Discuss.

(b) What are debentures ? What are the different types of debentures that can be issued by a joint stock company ? Explain briefly. 2+6=8

(c) What is reserve ? Explain the various types of reserves that can be maintained by a company. 2+6=8

(d) What are the functions of SEBI in respect of issue of capital ?

(e) What is the scope of financial management ? What are the functions of a finance manager ? 4+4=8

(f) Dell Ltd. has the following book value capital structure :

	(in ₹ millions)
Equity capital (10 million shares @ ₹ 10 per share)	100
11% Preference Capital (1,00,000 shares @ ₹ 100 per share)	10
Retained earnings	120
13·5% Debentures (5,00,000 debentures @ ₹ 100 per debenture)	50
12% Term loans	80
	360

The next expected dividend per share is ₹ 1·50. The dividend per share is expected to grow at the rate of 7%. The market price per share is ₹ 20. Preference stock, redeemable after 10 years is currently selling for ₹ 75 per share. Debentures redeemable after 6 years are selling at ₹ 80 per debenture. The tax rate applicable for the company is 50%. Calculate the weighted average cost of capital using market value proportions.

(g) Mozilla Ltd. belongs to a risk class for which the appropriate capitalisation rate is 10%. It currently has outstanding 50,000 shares selling at ₹ 100 each. The firm is contemplating the declaration of dividend of ₹ 6 per share at the end of the current financial year. The company expects to have a net income of ₹ 5,00,000 and has a proposal for making new investments of ₹ 10,00,000. Show that under MM• hypothesis, the payment of dividend does not affect the value of the firm.

(h) Explain the theories of capital structure.

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