Financial Management

Standard difficulty · 20 questions · 40 marks · Time: 39 minutes

Name: _____ Date: _____ Score: ____ / 40

Show your working for Sections B and C. Answers are on the last page — try every question first!

Section A — Choose the correct answer — 8 × 1 = 8 marks

1. The main objective of financial management is to:

(a) minimise taxes **(b)** maximise the number of employees
(c) maximise sales **(d)** maximise shareholders' wealth

2. What is meant by "financial leverage"?

(a) the proportion of debt in total capital
(b) deciding on long-term investment in fixed assets
(c) the part of profit distributed to shareholders
(d) investment in current assets

3. Which of these is a investment decision?

(a) The firm decides to keep its dividend steady though profits fell.
(b) The board decides to pay no dividend this year to fund growth.
(c) The firm decides whether to buy a new machine or repair the old one.
(d) The firm decides whether to raise ₹5 crore by shares or by debentures.

4. Which of these situations needs more working capital?

(a) Prices of raw materials are rising fast.
(b) A firm has a very short production cycle.
(c) Raw materials are easily available all year.
(d) A restaurant sells only for cash.

5. A firm keeps extra stock because materials arrive irregularly. Which factor affecting working capital is this?

(a) credit availed **(b)** growth prospects
(c) availability of raw material **(d)** scale of operations

6. A firm's current assets are ₹460,000 and its current liabilities are ₹340,000. What is its net working capital?

(a) ₹120,000 **(b)** ₹340,000 **(c)** ₹460,000 **(d)** ₹800,000

7. A firm has total funds of ₹2,000,000 and earns EBIT of ₹240,000. What is its return on investment?

(a) 10% **(b)** 6% **(c)** 24% **(d)** 12%

8. A company's EBIT is ₹100,000 and its interest charge is ₹40,000. What is its interest coverage ratio?

(a) 2.5 times **(b)** 3.5 times **(c)** 0.4 times **(d)** 5 times

Section B — Short answer — 8 × 2 = 16 marks

9. What is financial management?

10. Explain each term: (a) fixed capital (b) capital budgeting

11. Which financial decision is involved in each case? (a) The firm decides to keep its dividend steady though profits fell. (b) The firm decides whether to buy a new machine or repair the old one.

12. Does each situation need more or less working capital? (a) A firm runs very efficiently, turning stock over quickly. (b) Prices of raw materials are rising fast.

13. A firm has bills receivable ₹170,000, cash in hand ₹40,000, raw materials ₹200,000, and current liabilities of ₹280,000. Find (a) its current assets (b) its net working capital.

14. A company has total funds of ₹9,000,000, of which ₹2,000,000 is debt at 12%; the rest is equity in shares of ₹10 each. EBIT is ₹720,000 and tax is 25%. Find the EPS.

15. A firm earns a return on investment of 15% and can borrow at 10%. Will trading on equity raise its EPS? Why?

16. A company has equity of ₹4,700,000 and debt of ₹3,525,000. Find its debt–equity ratio.

Section C — Word problems — 4 × 4 = 16 marks

17. Explain the three financial decisions.

18. Match each with its meaning: (a) dividend (b) capital budgeting (c) fixed capital. Choose from: deciding on long-term investment in fixed assets; investment in long-term assets; the part of profit distributed to shareholders.

19. Read about Navrang Paints Ltd. (a) The board decides to pay no dividend this year to fund growth. (b) The firm decides how much to keep in stock and cash. (c) The firm decides whether to raise ₹5 crore by shares or by debentures. Identify the financial decision in each part and explain it briefly.

20. Tarang Motors Ltd needs total funds of ₹3,000,000 and expects EBIT of ₹360,000; tax is 25%; shares are of ₹10 each. Option I: all equity. Option II: ₹1,000,000 as 10% debt and the rest equity. (a) Find the EPS under each option. (b) Which gives the higher EPS? (c) Explain why, using ROI.

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Answer key

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Q	Answer	Working
1	(d) maximise shareholders' wealth	—
2	(a) the proportion of debt in total capital	—
3	(c) The firm decides whether to buy a new machine or repair the old one.	—
4	(a) Prices of raw materials are rising fast.	—
5	(c) availability of raw material	—
6	(a) ₹120,000	460,000 − 340,000
7	(d) 12%	240,000 ÷ 2,000,000 × 100
8	(a) 2.5 times	100,000 ÷ 40,000
9	Managing the flow of funds: getting the right amount of funds at the right time and cost, and using them well.	—
10	(a) investment in long-term assets (b) deciding on long-term investment in fixed assets	—
11	(a) dividend decision (b) investment decision	—
12	(a) less working capital (b) more working capital	—
13	(a) ₹410,000; (b) ₹130,000	170,000 + 40,000 + 200,000; 410,000 − 280,000
14	₹0.51	EBT = 720,000 − 240,000; EAT = EBT × 0.75; ÷ 700,000 shares
15	Yes: ROI (15%) is higher than the cost of debt (10%).	trading on equity helps only when ROI > rate of interest
16	0.75	3,525,000 ÷ 4,700,000
17	Investment decision (where to invest: fixed and current assets), financing decision (how to raise funds: debt or equity) and dividend decision (how much profit to distribute and how much to retain).	—
18	(a) the part of profit distributed to shareholders (b) deciding on long-term investment in fixed assets (c) investment in long-term assets	—
19	(a) dividend decision: how much of the profit is distributed and how much retained (b) investment decision: how	—

Q	Answer	Working
	the firm's funds are invested in different assets (c) financing decision: the quantum of finance to be raised from various sources	
20	**(a) I: ₹0.9; II: ₹0.98 (b) with debt (c) ROI is 12% against a cost of debt of 10%; debt raises EPS only when ROI is higher than the interest rate**	ROI = 360,000 ÷ 3,000,000 × 100; EPS = (EBIT − interest) × 0.75 ÷ shares