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*Your Roll No................*

## M.Com./I Sem. (OC) G

Paper : 6104 : FINANCIAL MANAGEMENT AND POLICY

*Time : 3 Hours* *Maximum Marks : 100*

*(Write your Roll No. on the top immediately on receipt of this question paper.)*

Attempt *all* questions.

1. (*a*) What is the objective of financial management ? Why is it superior to profit maximization objective ? What are the new objectives emerging in the wake of rising concern for corporate social responsibility ? 10

(*b*) (*i*) Project A has life of 5 years and NPV of Rs. 30,000. Project B has life of 7 years and NPV of Rs. 45,000. Can we say that if both projects are accepted, the total NPV would be Rs. 75,000 ? Why If both the projects are mutually exclusive which project should be selected ? Assume that the cost of capital is 10%.

P.T.O.

(*ii*) Differentiate between Risk adjusted discount rate method and Certainty Equivalent method for incoroporating risk and uncertainty in capital budgeting decisions. 10

*Or*

(*c*) Explain the following : 10

(*i*) Agency problem

(*ii*) Modified internal rate of return.

(*d*) A company is considering the following two mutually exclusive projects :

| Project | X | Y |
|---|---|---|
| Cash outlay (Rs.) | 2,00,000 | 3,50,000 |
| Expected NPV (Rs.) | 90,000 | 2,17,000 |
| Standard deviation (Rs.) | 40,000 | 1,25,000 |

Which project should be selected if :

(*i*) the company wants to select the less risky project.

(*ii*) If the capital is limited and company wants to maximize its return per rupee invested.

(*iii*) If there is no capital constraint. 10

(*a*) Explain Trade off theory of capital structure. How is it different from Net Income theory ? 10

(*b*) A company's income statement is given below :

| | (Rs. Lakhs) |
|---|---|
| Sales | 1200 |
| *Less* : Costs | 950 |
| EBIT | 250 |
| *Less* : Interest | 0 |
| PBT | 250 |
| *Less* : Tax @ 40% | 100 |
| PAT | 150 |
| No. of enquity shares | 30 |
| EPS | 5 |

The company is considering the proposal of an expansion programme. It will require Rs. 100 lakhs of additioanl funds to implement the programme. The additional funds can be raised through equity capital by issuing 5 lakh equity shares at Rs. 20 each or through 15% debentures for Rs. 50 lakhs and 2.5 lakh equity shares for Rs. 20 each. The company's expected EBIT after the expansion programme is given below :

| EBIT (Rs. lakh) | Pi |
|---|---|
| 150 | 0.1 |
| 350 | 0.3 |
| 440 | 0.5 |
| 500 | 0.1 |

Calculate :

(*i*) The indifference level EBIT between the two financial plans.

(*ii*) The expected EPS under both the plans after expansion.

(*iii*) Which plan would you recommend and why ? Specify any additional assumption made by you while answering this part. 10

*Or*

(*c*) How information asymmetry affects capital structure choice ? Explain in the context of signaling theory of capital structure. 10

(*d*) TYK Ltd. is considering an expansion plan requiring an outlay of Rs. 500 lakhs. The management of the company is convinced that debt is cheaper source of finance and is confident that it can raise the entire amount at 14% debt. However there is some apprehension about the firm's ability to meet interest burden during a recessionary year. The management feels that in a recessionary year, the net cash inflows of the company, not taking into account the interest burden on new debt would have an expected value of Rs. 100 lakhs with a standard deviation of Rs. 40 lakhs. Assume that the cash inflows follow a normal distribution.

(*i*) What is the probability of cash inadequacy during a recessionary year, if the entire amount of Rs. 500 lakhs is raised through debt ?

(*ii*) If the management is prepared to accept 5% chance of cash inadequacy, what proportion of Rs. 500 lakhs should be raised as debt finance ? 10

3. (*a*) Explain the following

(*i*) Walter's Model

(*ii*) Dividend signaling theory. 10

(*b*) The present sales of Lal Ltd. are Rs. 150 Lakhs, average collection period is 35 days, variable cost to sales ratio is 0.85, post tax cost of capital is 12%, bad debt ratio is 1% and corporate tax rate is 30%. The company has a rigorous cash collection policy and therfore loses some sales to its competitors. The finance manager of the company has suggested to reduce collection efforts and save Rs. 40,000 collection costs. If the collection efforts are reduced, the sales will increase by Rs. 24 lakh, average collection period will increase to 40 days and bad debt ratio to 2% of total sales. Assume 360 days in a year.

Should the company accept the suggestion of its finance manager ? Show all calculations. 10

*Or*

(*c*) Explain the following 10

(*i*) Ageing schedule

(*ii*) Concentration banking.

(*d*) Explain the various factors affecting dividend policy of a company. 10

4. (*a*) Explain Baumolls model of cash management ? How is Miller-Orr Model better than Baumol's Model ? 10

(*b*) W Ltd. is keen on reporting an earing per share of Rs. 8 after acquiring L Ltd. The financial data of the two companies before acquisition are given below :

| | W Ltd. | L Ltd. |
|---|---|---|
| EPS (Rs.) | 6 | 5 |
| Market price per share (Rs.) | 80 | 60 |
| No. of shares | 15,00,000 | 6,00,000 |

There is an expected synergy gain of 10% in total earnings after merger. What exchange ratio will result in a post merger earnings per share of Rs. 8 for W Ltd ? 10

*Or*

(*c*) Explain the following : 10

(*i*) Divestiture

(*ii*) Motives of Mergers ~~and~~ Acquisition

(*d*) What are the factors affecting working capital requirement ? Explain citing examples. 10

5. Attempt any *two* out of the following : 10+10

(*i*) Approaches to working capital financing

(*ii*) Scenario analysis in the context of capital budgeting

(*iii*) Demerger and Divestiture.