

QUESTIONS WITH ANSWERS FOR PRACTICE

CHAPTER/UNIT-9-FINANCIAL MANAGEMENT

Important questions are shown with * mark and the Most important questions are shown with ** mark

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| *1. Name the cheapest source of finance to a company. | 1M |
| Ans. Debt capital | |
| 2. Name the decision to acquire a new and modern plant to upgrade an old one. | 1M |
| Ans. Investment decision | |
| **3. What is meant by Capital Structure? | 1M |
| **4. Enumerate three important decisions taken in financial management. | 1M |
| 5. What is the link between operating cycle and working capital? | 1M |
| **6. Canara Bank wants to open a new branch of his bank? What is this decision called? | 1M |
| Ans. Investment decision | |
| *7. What is the cost of raising funds called? | 1M |
| Ans. Floatation cost | |
| 8. Why investors want dividend? | 1M |
| 9. Define business finance. | 1M |

- 10. How the EPS is computed?** **1M**
 Ans. Earnings available for equity shareholders/No. of equity shares
- 11. How the Interest Coverage Ratio is computed?** **1M**
 Ans. EBIT/Interest
- 12. How the Return on Investment is computed?** **1M**
 Ans. EBIT/Capital Employed X 100
- *13. Which is the most costly capital for a company?** **1M**
 Ans. Equity share capital
- 14. Name the concept which increases the return on equity shares with a change in the capital structure of a company.** **1M**
 Ans. Trading on Equity
- **15. State why the working capital needs for a 'Service-industry' are different from that of a Manufacturing industry.** **1M**
 Ans. Service industries need less working capital because they do not require any inventory.
 They do not have any manufacturing process.
- **16. Name any two essential ingredients of sound working capital management.** **1M**
 Ans. Inventory, debtors
- **17. 'Cost of debt' is lower than the 'cost of equity share capital' Give reasons why even then a company cannot work only with the debt.** **1M**
 Ans. A company cannot exist without equity share capital
- *18. What is meant by Gross working capital?** **1M**
 Ans. Total investment on current assets (Current liabilities should not be deducted)
- 19. Name that portion of current assets which is financed by fixed liabilities.** **1M**
 Ans. Net working capital
- 20. Why is working capital needed? Give any one reason.** **1M**
 Ans. It is required to meet day to day expenses.
- 21. Discuss two objectives of financial planning.** **3M**
- 22. What is financial risk? Why does it arise?** **3M**
- 23. Define current assets and give four examples.** **3M**
- 24. Financial management is based on three broad financial decisions. What are these?** **3M**

- **25. What is the main objective of financial management?** **3M**
- 26. Discuss about working capital affecting both liquidity as well as profitability of a business.** **3M**
 Hint: The working capital should neither be more or less than required. Both these situations are harmful. It is considered as a necessary evil.
- 27. How does cost of capital affect the capital structure of a company?** **3M**
- *28. “Sound Financial Management is the key to the prosperity of business: Explain** **3M**
 Hint: Role of financial management
- *29. Explain the factors affecting the investing decision of a company.** **3M**
- 30. State the two important objectives of financial planning.** **3M**
 Hint: i) To ensure timely availability of finance ii) To ensure proper balance of finance.
- 31. Explain the meaning of Fixed Capital. Explain any two factors that determine the fixed capital of a company.** **3M**
- 32. What is the role of ‘Leasing’ in determining the requirement of fixed capital?** **3M**
- 33. ‘Fixed capital decisions involve more risk’ How?** **3M**
- 34. How ‘scale of operations’ affect the requirement of fixed capital?** **3M**
- 35. Length of production cycle affects the working capital requirements of an organisation. Explain** **3M**
- 36. How are ‘Growth Prospects’ related with the requirement of working capital?** **3M**
- 37. How does ‘Risk consideration’ affect the capital structure decision?** **3M**
- 38. How ‘Capital Structure of other companies’ affects the capital structure decision?** **3M**
- 39. What do you mean by Financial Leverage?** **3M**
 Hint: Trading on equity
- 40. Explain the ‘Earnings Before Interest and Taxes’ - EBIT** **3M**
- 41. “Share Capital is better than debt capital” In the favour of this statement explain one factor which affects the capital structure.** **3M**
 Hint: Cash flow position or other relevant point which favours equity capital
- 42. When debt capital is cheaper than the equity capital, why don’t companies go for debt capital alone?** **3M**
 Hint: A public company cannot be incorporated without equity share capital
- 43. How the control of existing shareholders affects? How this situation can be avoided?** **3M**
 Hint: This situation can be avoided by raising debt capital rather than equity capital

44. "Tax benefit is available only in case of payment of interest and not on the payment of preference dividend "Why **3M**

Hint: Interest on debt only tax deductible expense but not preference dividend.

45. 'Capital structure decision is essentially optimization of risk-return relationship' Comment **4M**

46. A Capital budgeting decision is capable of changing the financial fortune of a business. Do you agree? Why or Why not? **4M**

47. What is the importance of capital budgeting decisions? **4M**

****48. To avoid the problems of shortage and surplus of funds what is required in financial management? Name the concept and explain its any three points of importance.** **4M**

Hint: Financial Planning.

49. Explain briefly any four points of the role of financial management. **4M**

50. To tackle the uncertainty in respect of availability and timings of funds what is required? Name the concept involved and explain its three points of importance. **4M**

Hint: Financial planning

****51. Name the process which helps in determining the objectives, policies, procedures, programmes and budgets to deal with the financial activities of an enterprise. Explain its three points of importance.** **4M**

Hint: Financial Planning

52. Explain by giving any four reasons, why capital budgeting decisions are important. **4M**

53. What is the meaning of Financial Planning? Why is it important? Give any two reasons. **4M**

****54. Explain the factors affecting the dividend decision.** **5M**

****55. Explain the term 'Trading on Equity'. Why, When and How it can be used by a business organisation?** **5M**

56. "A sound financial plan is the key to success of sound financial management of the company" Discuss **5M**

Hint: Importance of Financial Planning.

***57. How can the return on equity be increased by using debt in the capital structure? Illustrate with a suitable example.** **5M**

Hint: Trading on equity.

58. "Financial planning does not serve any useful purpose" Comment **5M**

Hint: No, Explain the importance

****59. A businessman who wants to start a manufacturing concern approaches you to suggest him whether the following manufacturing concerns would require large or small working capital:**

i) Bread ii) Sugar iii) Furniture manufacturing against specific order iv) Cool ers v) Motor Car **5M**

Hint: i) Bread – less ii) Sugar – More iii) Furniture manufacturing against specific order – less iv) Coolers – More v) Motor Car - More.

60. What is meant by financial management? Explain any three decisions involved in it. **5M**

****61. Explain the meaning of fixed capital. Briefly explain any four factors that determine the fixed capital of a company.** **5M**

62. Explain any five factors which affect the dividend policy of a company. **5M**

63. “Financial Planning does not serve any useful purpose” Comment **5M**

64. How are shareholders likely to gain with a loan component in the capital employed? Briefly explain **5M**

Hint: Trading on equity

****65. “Determining the overall cost of capital and the financial risk of the enterprise depends upon various factors.” Explain any five such factors.** **5M**

Hint: Factors affecting capital structure

****66. You are a Finance Manager of a newly established company. The Directors have asked you to determine the amount of Fixed Capital requirement for the company. Explain any four factors that you will consider while determining the fixed capital requirement for the company.** **6M**

****67. What is working capital? How is it calculated? Discuss five important determinants of working capital requirements.** **6M**

****68. Explain any six factors which affect the capital structure of a company.** **6M**

****69. What is fixed capital management? Explain any five factors determining the amount of fixed capital.** **6M**

70. What is meant by financial management? Explain its role. **6M**

****71. Explain any six factors affecting the financing decision of a company.** **6M**

72. Explain any six factors affecting the dividend decision of a company. **6M**

73. What do you mean by financial planning? Discuss the importance of financial planning in financial management. **6M**

74. The Board of Directors has asked you to design the capital structure of the company. Explain any six factors that you would consider while doing so. **6M**

75. “Determination of capital structure of a company is influenced by a number of factors” Explain any four such factors

6M

Case Studies

Que. 1: ‘S’ Limited is manufacturing steel at its plant in India. It is enjoying a buoyant demand for its products as economic growth is about 7%-8% and the demand for steel is growing. It is planning to set up a new steel plant to cash on the increased demand it is facing. It is estimated that it will require about `5000 crores to set up and about `500 crores of working capital to start the new plant.

What is the importance of having a financial plan for this company? Give an imaginary plan to support your answer.

Sol.1. Importance of financial planning: (a) It tries to forecast what way may happen in the future under different business situations. (b) In other words, it makes the firm better prepared to face the future (c) It helps in avoiding business shocks and surprise and helps the company in preparing for the future. (d) It helps in co-ordinating various business functions e.g., sales and production functions, by providing clear policies and procedures. (e) Detailed plans of actions prepared under financial planning reduce waste, duplication of efforts and gaps in planning. (f) It tries to link the present with the future. (g) It provides a link between investment and financing decisions on a continuous basis. (h) By spelling out detailed objectives for various business segments. It makes the evaluation of actual performance easier.

Value Based Questions

Value Based Questions:

Q.1 In a company profits are heavy and in future less scope of expansion exists. Company has decided to pay a very less dividends. Here which value and whose interest have been affected?

Q.2 A company wants to show higher profit and for this:

- a) Depreciation was charged at lower rates.
- b) Goodwill, Patents, Trademarks and other intangible assets were shown at higher value. Explain the value which is affected here?

Q.3 A wholesaler of onion comes to know that due to less production the prices of onion will increase heavily. He store the onion and during rising prices. Earn heavy profits by selling the stored onion. From the earned profits he provides some money for social activities also. In this situation which values he affects here.

Answers

Ans1

- i) Production of inferior quality goods. ii) Exploitation of consumers.

Ans2

- i) To show respect to elderly employees ii) Should not use ugly language/bad words.
- iii) Without enquiring, scolding is bad/not to be done.

Ans3

- i) wastage of time.
- ii) Union not to make unnecessary pressure of officials
- iii) Threatening to strike on small matters is unhealthy practice