	which go beyond the permissible limits should be brought to the notice of the management. Like in the above case, the output defects up to 2% may be considered acceptable but if it goes up by 5%, it may call for managerial action.	
30	1. Two benefits which the company will derive from a good control system are: a) Accomplishing organizational goals of increasing market share and customer satisfaction. b) Making efficient use of resources by controlling wastage and spoilage of resources; and ensuring that each activity is performed according to the predetermined standards. 2. a) Controlling will improve future planning by providing information to the company derived from past experience that its targets were not met with regard to sales and customer satisfaction. b) The company should undertake technological up gradation of machinery, and modify the existing process so that cost is reduced and the company can set lower price for its mobile phones to bet its competitors.	**6**

Chapter 9 FINANCIAL MANAGEMENT

Marks (unit 9 & unit 10 carries 15 marks)

Important Points

Clue words in the case study

- Decision affecting liquidity and profitability of a business- Short term investment decision/ Working capital decisions
- Decision affecting financial risk and profitability of a business- capital structure decisions
- Decisions that relates to fund requirements both in terms of the quantum as well as the timing- financial planning
- Concerned with quantum of finance to be raised from various long term sources- Financing Decisions

- Decisions affecting Growth, Financial risk and profitability of a business- capital budgeting decisions

Points to be remember for solving the case studies

- Always read the question first what the question want
- Important line and points should be underlined at the time of reading the case
- In this chapter you just remember five major decisions- capital budgeting decisions, financing decision, dividend decision, working capital and fixed capital decisions and concepts-financial planning, trading on equity etc.
- Numerical questions also asked in this chapter

1	The cheapest source of finance is: (a) Debenture (b) Equity share capital (c) Preference shares (d) Retained earnings	1
2	Other things remaining the same, an increase in the tax rate on corporate profits will: (a) Make the debt relatively cheaper (b) Make the debt relatively the dearer (c) Have no impact on the cost of debt We can't say	1
3	Financial leverage is called favourable if : (a) Return on investment (ROI) is lower than the cost of debt (b) ROI is higher than the cost of debt (c) Debt is easily available (d) If the degree of existing financial leverage is low	1

4	Higher debt-equity ratio results in: (a) Lower financial risk (b) Higher degree of operating risk (c) Higher degree of financial risk (d) Higher EPS	1
5	Current assets are those assets which get converted into cash: (a) Within six months (b) Within one year (c) Between one and three years Between three and five years	1
6	Financial planning arrives at : (a) Minimising the external borrowing by resorting to equity issues (b) Entering that the firm always have significantly more fund than required so that there is no paucity of funds (c) Ensuring that the firm faces neither a shortage nor a glut of unusable funds. (d) Doing only what is possible with the funds that the firms has at its disposal	1
7	A fixed asset should be financed through : (a) A long-term liability (b) A short-term liability' (c) A mix of long and short-term liabilities	1
8	Current assets of a business firm should be financed through: (a) Current liability only (b) Long-term liability only (c) Both types (i.e. long and short-term liabilities)	1
9	Long-term investment decisions are also called as (a) Working capital decisions (b) Capital budgeting decisions (c) Dividend decision (d) Financing decisions	1
10	This decision affects the liquidity and short term profits of the company (a) Long term investment decision (b) Working capital investment decision (c) Financing decision All the above	1
11	Financial risk of a company increases because of (a) High operating cost (b) High fixed cost charges	1

	(c) High rate of dividends (d) High debt-equity ratio	
12	Debts financing is better than equity if (a) Company has strong cash flow (b) Company has weak cash flow (c) Cash flow position does not matter (d) None of the above	1
13	The size of assets, the profitability and competitiveness are affected by ____________ decision.	1
14	Dividend is that portion of__________which is distributed among shareholders.	1
15	Short term investment decision is also known as________________decision.	1
16	___________decision determines the overall cost of capital.	1
17	_______________techniques of evaluating investment proposals.	1
18	___________decision taken in financial management which affects the liquidity as well as profitability of business.	1
19	The main objective of financial management is____________.	1
20	Higher amount of debt indicates__________interest expense in future.	1
21	Investment for long term is called_________________decisions.	1
22	___________decision taken in financial management related to acquire a new & modern plant and to upgrade an old one.	1
23	Working capital decision is a decision to acquire a new and modern plant to upgrade an old one.(true /false)	1
24	Trading on equity takes place when ROI is more than the rate of interest on debt. .(true /false)	1
25	Debt component of capital structure determines the overall financial risk. .(true /false)	1
26	Long term investment decisions facilitates smooth day to day operations of the business.(true /false)	1
27	Working capital is the excess of current assets over current liabilities. .(true /false)	1
28	The main objective of financial management is to maximize profit. .(true /false)	1
29	Financial management is the concept which link the present with the future. .(true /false)	1
30	Dividend is the portion of retained earnings which is distributed to shareholders.(true /false)	1

31	**<u>Match the columns</u>** **<u>1.</u>** **(A)** **(B)** 1. Decision affecting liquidity and profitability of a business (a) Financial planning 2. Decision affecting financial risk and profitability of a business (b) capital budgeting decisions 3. Decisions that relates to fund requirements both in terms of the quantum as well as the timing (c) working capital decisions 4. Decisions affecting Growth, Financial risk and profitability of a business (d) Capital structure	1
32	**<u>Match the columns</u>** **(A)** **(B)** 1. ROI is more than the Rate of interest on de (a) Unfavourable financial leverage 2. ROI is less than the rate of interest on debt (b) Trading on equity 3. Objective of financial management (c) Funds available at right time 4. Objective of Financial planning (d) Maximize shareholder's wealth	1

<u>Case Studies</u>

S.NO.	QUESTIONS	MARKS
1	In the paint industry, various raw materials are mixed in different proportions with petroleum for manufacturing different kinds of paints. One specific raw material is not readily and regular available to the paint manufacturing companies. Bonler Paints Company is also facing this problem and because of this there is a time lag between placing the order and the actual receipt of the material. But, once it receives the raw materials, it takes less time in converting it into finished goods. Identify the factor affecting the working capital requirements of this industry.	1
2	Aarohan Ltd. An automobile manufacturer was diversifying into manufacturing two-wheelers. They knew that India is on a growth path and a new breed of consumer is eager for a first vehicle. The market responded very well to the new product.	1

	The company did not have to allow credit, as it had advance orders from four to six months with deposits paid. Also, due to efficiency in managing their operations as soon as a vehicle was off the assembly line, it was out to the dealers. Give any one reason discussed above which helped the firm in managing its working capital efficiently.	
3	Ravi, after leaving his job, wanted to start a Private Limited Company with his son. His son was keen that the company may start manufacturing mobile-phones with some unique features. Ravi felt that mobile phones are prone to quick obsolescence and a heavy fixed capital investment would be required regularly in this business. Therefore, he convinced his son to start a furniture business. Identify the factor affecting fixed capital requirements which made Ravi choose the furniture business over mobile phones.	1
4	Amar is doing his transport business in Delhi. His buses are generally used for tourists going to Jaipur and Agra. Identify the working capital requirements of Amar. Give reasons to support your answer.	1
5	A bank may use another's ATM or some of them may jointly establish a particular facility. Name the factor affecting the fixed capital requirements of each bank.	1
6	Shyam wanted to start a business of selling handicrafts by getting in touch with the craftsmen in the rural areas of Bengal. He wants to make a low investment in fixed capital. Advice him in taking suitable decisions regarding the Nature of Business, Scale of operations and Financing Alternatives (in a developed financial market) that he needs to take for the purpose.	3
7	Yogesh, a businessman is engaged in purchasing and selling of Ice-creams. Identify the working capital requirement of Manish giving reasons in support of your answer. Explain any two factors that will affect his fixed capital requirements.	3
8	Pinnacle Ltd. deals in the sale of stationery and office furniture. They source the finished products from reputed brands who gave them four to six months credit. Seeing the demand for electronic items, they are also planning to market these items by opening outlets throughtout India. For this, they have decided to join hands with a Japanese electronic goods manufacturer. Identify and state any two factors that would affect the fixed capital requirement of pinnacle Ltd. as discussed above.	3
9	Saksham Ltd. a firm manufacturing textiles, wished to diversify their business. They were considering two options, either to diversify into manufacturing tooth-paste or switches. They wanted to invest in the purchase of land, to set up a	4

	manufacturing unit in the backward areas of Gujarat, which would also lead to the generation of employment opportunities in the area, but only after fulfilling all legal requirements and taking appropriate steps to ensure that the environment was not polluted. The finance manager of the company, Mr. Ramakant was asked by the management to prepare a report on the factors which should be considered while making the above investment decision. (A) State any two factors that Mr. Ramakant would give in his report. (B) Also state any one reason which makes it important for the above decision to be made carefully.	
10	Somnath Ltd. is engaged in the business of export of garments. In the past, the performance of the company had been upto the expectations. In line with the latest technology, the company decided to upgrade its machinery. For this, the Finance Manager, Dalmia estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis. Dalmia therefore, began with the preparation of a sales forecast for the next four years. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources of the business. For the remaining funds he is trying to find out alternative sources from outside. Identify the financial concept discussed in the above para. Also state the objectives to be achieved by the use of financial concept, so identified.	4
11	A business that doesn't grow dies", says Mr. Shah, the owner of Shah Marble Ltd. with glorious 36 months of its grand success having a capital base of Rs.80 crores. Within a short span of time, the company could generate cash flow which not only covered fixed cash payment obligations but also create sufficient buffer. The company is on the growth path and a new breed of consumers is eager to buy the Italian marble sold by Shah Marble Ltd. To meet the increasing demand , Mr. Shah decided to expand his business by acquiring a mine. This required an investment of Rs.120 crores. To seek advice in this matter, he called his financial advisor Mr. Seth who advised him about the judicious mix of equity(40%) and Debt(60%). Mr. Seth also suggested him to take loan from a financial institution as the cost of raising funds from financial institutions is low. Though this will increase the financial risk but will also raise the return to equity shareholders. He also apprised him that issue of debt will	6

	not dilute the control of equity shareholders. At the same time, the interest on loan is a tax deductible expense for computation of tax liability. After due deliberations with Mr. Seth, Mr. Shah decided to raise funds from a financial institution. (a) Identify and explain the concept of financial management as advised by Mr. Seth in the above situation. (b) State the four factors affecting the concept as identified in part (a) above which have been discussed between Mr. Shah & Mr. Seth.	
12	Shalini, after acquiring a degree in Hotel management and Business Administration, took over her family food processing company of manufacturing pickles, jams and squashes. The business had been established by her great grandmother and was doing reasonably well. However, the fixed operating costs of the business were high and the cash flow position was weak. She wanted to undertake modernization of the existing business to introduce the latest manufacturing processes and diversify into the market of choclates and candies. She was very enthusiastic and approached a finance consultant, who told her that approximately Rs.50 lakh would be required for undertaking the modernization and expansion programme. He also informed her that the stock market was going through a bullish phase. (a) Keeping the above considerations in mind, name the source of finance Shalini should not choose for financing the modernization and expansion of her food processing business. Give one reason in support of your answer. (b) Explain any two other factors, apart from those stated in the above situation, which Shalini should keep in mind while taking this decision.	6
13	'Sarah Ltd' is a company manufacturing cotton yarn. It has been consistently earning good profits for many years. This year too it has been able to generate enough profit. There is availability of enough cash in the company and good prospect for growth in future. It is a well managed organisation believes in quality, equal employment opportunities and good remuneration practices. It has many shareholders who prefer to receive a regular income from their investments. It has taken a loan of Rs 40 lakh from IDBI and is bound by certain restrictions on the payment of dividend as per terms of loan agreement. The above discussion about the company leads to various factors which decide how much of the profit should be retained and how much about to be distributed by the company. Quoting the lines from the above discussion Identify and explain any four such factors.	6
14	Well being Ltd. is a company engaged in production of organic foods. Presently, it sells its products through indirect channels of distribution. But, considering the sudden surge in the demand	6

	for organic products, the company is now inclined to start its online portal for direct marketing. The financial mangers of the company are planning to use debt in order to take advantage of trading on equity. In order to finance its expansion plans, it is planning to raise a debt capital of Rs.40 lakhs through a loan @ 19% from an industrial bank. The present capital base of the company comprises of Rs.9 lakh equity shares of Rs.10 each. The rate of tax is 30%. In context of the above case: (a) What are the two conditions necessary for taking advantage of trading on equity? (b) Assuming the expected rate of return on investment to be same as it was for the current year i.e. 15%, do you think the financial managers will be able to meet their goal. Show your workings clearly.	

Answers

Multiple choice questions

Ans.1 (a)

Ans.2 (a)

Ans.3 (b)

Ans.4 (c)

Ans.5 (b)

Ans.6 (c)

Ans.7 (a)

Ans.8 (c)

Ans.9 (b)

Ans.10 (b)

Ans.11 (d)

Ans.12 (a)

Fill in the blanks

(i) Capital budgeting
(ii) Profit

(iii) Working capital
(iv) Financing decisions
(v) Capital budgeting techniques
(vi) Working capital
(vii) Maximize shareholder's wealth
(viii) High
(ix) Capital budgeting
(x) Long term investment decision

True/False

1. False
2. True
3. True
4. False
5. True
6. False
7. False
8. False

Match

1. 1-(c). 2-(d), 3-(a), 4-(b)
2. 1-(b), 2-(a), 3-(d), 4-(c)

<u>Case Studies</u>

Ans. No.	Answers
1	Availability of raw material
2	Credit allowed
3	Technological upgradation
4	Working capital requirements of Amar will be relatively less as he is engaged in providing transport services wherein there is no need to maintain inventory.
5	Level of collaboration
6	Shyam should take into account the following points while taking decisions along the following factors: (a) Nature of Business: it is advisable that shyam starts a trading concern and engages in buying handicrafts from the craftsmen and selling them

	directly to the prospective buyers. He should not plan to set up a manufacturing unit as he wants to make a low investment in fixed capital. (b) Scale of operations: it is advisable that initially shyam carries out his business on a small scale. (c) Financing alternatives: It is advisable that shyam may opt for procuring fixed assets on lease instead of purchasing them as h wishes to make a low investment in fixed capital. Moreover in a developed financial market leasing facilities are easily available.
7	Working capital will be less as he is engaged in trading business. Factors affecting fixed capital Level of collaboration and financial alternatives available
8	Diversification and level of collaboration
9	(a) A long term investment decision is also called a capital budgeting decision. The factors that should be kept in mind by the company while making the investment decision are as follows: (A) Cash inflows from the project (B) Rate of return (b) Due to the following one reason the above decision is to be made carefully: It affects the overall level of business risk of the organization and its growth and profitability of business in future.
10	Financial Planning Objectives: (a) To ensure availability of funds whenever required (b) To see that the firm does not raise resources unnecessarily.
11	(a) Capital structure (b) Factors: (i) Cash flow position (ii) Risk consideration (iii) Tax rate (iv) Control
12	Debt because of high fixed operating cost and weak cash position Other two factors: Risk and flexibility
13	Any five factors: Growth opportunities, Stability of dividend, Legal restictions, Restrictions in loans agreement, liquidity, stability of earnings etc.
14	(a) The two conditions necessary for taking advantage of trading on equity are: (i) The rate of return on investment should be more than the rate of interest. (ii) The amount of interest paid should be tax deductible. (b)

Sources	Situation 1	Situation 2

		Equity shres	90,00,000	90,00,000
		10% Debentures	NIL	40,00,000
		Total capital	90,00,000	1,30,00,000
		EBIT	13,50,000	19,50,000
		Less: Interest	---------	(4,00,000)
		EBT	13,50,000	15,50,000
		Less: Tax @ 30%	(4,05,000)	(4,65,000)
		EAT	9,45,000	10,85,000
		No. of shares of Rs.10 each	9,00,000	9,00,000
		EPS	1.05	1.21