STELLA MARIS COLLEGE (AUTONOMOUS) CHENNAI – 86
(For candidates admitted during the academic year 2004– 05 & thereafter)

SUBJECT CODE : EC/PE/FM24

M. A. DEGREE EXAMINATION, APRIL 2008
BRANCH III – ECONOMICS
SECOND SEMESTER

COURSE : ELECTIVES
PAPER : FINANCIAL MANAGEMENT
TIME : 3 HOURS **MAX. MARKS : 100**

SECTION – A

ANSWER ANY FIVE QUESTIONS. ANSWER NOT TO EXCEED 300 WORDS.
(5 X 8 = 40)

1. Describe the close relationship between finance and economics and explain why the finance manager should possess a basic knowledge of economics. What is the primary economic principle used in managerial finance.

2. Briefly explain Capital Asset Pricing Model.

3. Write short note on
   a) Risk – return tradeoff
   b) Leverage
   c) Capital Rationing
   d) Wealth Maximisation

4. A project requires an initial outlay of Rs.20,000. It generates year ending profits of Rs.12000, Rs.6000, Rs.4000, Rs.10000 and Rs.10000 from the end of the first year to the end of the fifth year. The required rate of return is 10% and pays tax at 50%. The profit has a life of 5 years and is depreciated on straight line basis. Assume the above year ending profits are before depreciation and tax. You are required to compute the internal rate of return.

5. H Ltd. has a present annual rates level of 10,00 units at Rs.300 per unit. The variable cost per unit is Rs.200 p.u. and the fixed costs amounts to Rs.3,00,000 p.a. The present credit allowed by the company is one month. The company is considering a proposal to increase the credit period to two months and three months and has made the following estimates

Credit Policy	Existing Plan	Proposed Plan	
	1 month	2 months	3 months
Increase in Sales Percentage of bad debts.	1%	15% 3%	30% 5%

There will be an increase in fixed cost by Rs.50,000 on account of increase in sales beyond 15 per cent of present level. The company plans on a pre-tax return of 20% on investment in receivables. You are required to compute the most paying credit policy for the company.

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6. a) Z Ltd intend to invest Rs.15,000 p.a. at the end of years 5,6,7 and 8 at an annual interest rate of 12%. Find the present value of deferred annuity payments.

   b) Mr. X deposits Rs.2,000 at the end of every year for 5 years in his saving account paying 5% interest compounded annually. Determine how much sum of money he will have at the end of the 5th year.

7. a) Two components A and B are used as follows :

   Normal usage 50 units each per week..
   Minimum usage 25 units each per week.
   Maximum usage 75 units each per week.
   Re-order quantity A = 300 units
   B = 500 units.
   Re-order period A = 4 to 6 weeks
   B = 2 to 4 weeks.

   Calculate

   a) Re-order level b) minimum level
   c) maximum level d) Average Stock level

   b) P Ltd has been buying a given item in lots of 1200 units which is a six months supply, the cost per unit is Rs.12, order cost is Rs.8 per order and carrying cost is 25%. Find the Economic Order Quantity.

SECTION – B

ANSWER ANY THREE QUESTIONS. EACH ANSWER SHOULD NOT EXCEED 1200 WORDS. (3 x 20 = 60)

8. Explain the major financial management decisions take by business firms in detail.

9. What is capital budgeting decision. Why is it significant for a firm. Explain various types of capital budgeting proposals.

10. S Ltd has appointed you as its finance manager. The company wants to implement a project for which Rs.30 lakhs is required to be raised from the market as a means of financing the project. The following financing plans and options are at hand.

Particulars	Plan A	Plan B	Plan C
Option 1.			
Equity Shares	100%	100%	100%
Option 2			
Equity Shares	50%	66.67%	33.33%
12% Preference Shares	NIL	33.33%	33.33%
10% Non-convertible debenture	50%	NIL	33.33%

Assuming corporate tax to be 35% and the face value of all the shares and debentures to be Rs.100 each, calculate the indifference points and earnings per share for each of the financing plans with the confirmation table. Which plan should be accepted by the company.

11. a) Briefly explain the various long term sources of capital.
    b) The following data pertain to a shop. The owner has made the following sales forecasts for the first 5 months of the coming year.

Jan	40000
Feb	45000
Mar	55000
Apr	60000
May	50000

Other data are as follows:

(i) Debtors & creditors balances at the beginning of the year are Rs.30,000 and Rs.14,000 respectively. The balances of other relevant assets and liabilities are

Cash Balance	7,500
Stock	51,000

Accrued Sales commission 3,500.

(ii) 40% sales are on cash basis. Credit sales are collected in the month following sale.

(iii) Cost of sales 60% of sales.

(iv) The only other variable cost is a 5% commission to sales agents. The sales commission is paid in the month after it is earned.

(v) Inventory is kept equal to sales requirements for the next two months budgeted sales.

(vi) Trade creditors are paid in the following month after purchases.

(vii) Fixed costs are Rs.5,000 per month, including Rs.2,000 depreciation.

You are required to prepare a cash budget for ach of the first three months of coming year.

12. A plastic manufacturing company has under consideration the proposal of production of high quality plastic glasses. The necessary equipment to manufacture the glasses would cost Rs.1 lakh and would last 5 years. The tax relevant rate of depreciation is 25% on written down value. There is no other asset in this block. The expected salvage value is Rs.10,000. The glasses can be sold at Rs.4 each. Regardless of the level of production, the manufacturer will incur cash cost of Rs.25,000 each year the project is undertaken. The overhead cost allocated to this new line would be Rs.5,000. The variable costs are estimated at Rs.2 per glass. The manufacturer estimates it will sell about 75,000 glasses per year. The tax rate is 35% should the proposed equipment be purchased? Assume 20% cost of capital and additional working requirement Rs.50,000.

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