



### ASSIGNMENT

|                                |   |
|--------------------------------|---|
| <b>DRIVE</b>                   | <b>WINTER 2014</b>                            |
| <b>PROGRAM</b>                 | <b>MBA/ MBADS/ MBAFLEX/ MBAHCSN3/ PGDBAN2</b> |
| <b>SEMESTER</b>                | <b>II</b>                                     |
| <b>SUBJECT CODE &amp; NAME</b> | <b>MB0045<br/>FINANCIAL MANAGEMENT</b>        |
| <b>BK ID</b>                   | <b>B1628</b>                                  |
| <b>CREDITS</b>                 | <b>4</b>                                      |
| <b>MARKS</b>                   | <b>60</b>                                     |

Note: Answer all questions. Kindly note that answers for 10 marks questions should be approximately of 400 words. Each question is followed by evaluation scheme.

| Q.No | Questions  | Marks | Total Marks |
|------|--|-------|-------------|
| 1    | <i>Explain the liquidity decisions and its important elements. Write complete information on dividend decisions.</i>   |       |             |
|      | Explanation of liquidity decisions with its important elements   | 5     | 10          |
|      | Explanation of dividend decisions  | 5     |             |
| 2    | <i>Explain about the doubling period and present value. Solve the below given problem:<br/><br/>Under the ABC Bank's Cash Multiplier Scheme, deposits can be made for periods ranging from 3 months to 5 years and for every quarter, interest is added to the principal. The applicable rate of interest is 9% for deposits less than 23 months and 10% for periods more than 24 months. What will be the amount of Rs. 1000 after 2 years?</i> |       |             |
|      | Explanation of doubling period   | 2     |             |
|      | Solving the problem  | 3     | 10          |
|      | Explanation of present value   | 5     |             |
| 3    | <i>Write short notes on:<br/><br/>a) Operating Leverage<br/>b) Financial leverage<br/>c) Combined leverage</i>   |       |             |
|      | Explanation of operating leverage  | 4     | 10          |
|      | Explanation of financial leverage  | 4     |             |
|      | Explanation of combined leverage   | 2     |             |

| 4  | <p><b>Explain the factors affecting Capital Structure. Solve the below given problem:</b></p> <p><b>Given below are two firms, A and B, which are identical in all aspects except the degree of leverage employed by them. What is the average cost of capital of both firms?</b></p> <p style="text-align: center;"><b>Details of Firms A and B</b></p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th><b>Firm A</b></th> <th><b>Firm B</b></th> </tr> </thead> <tbody> <tr> <td><b>Net operating income EBIT</b></td> <td style="text-align: center;"><b>Rs. 1, 00, 000</b></td> <td style="text-align: center;"><b>Rs. 1, 00, 000</b></td> </tr> <tr> <td><b>Interest on debentures I</b></td> <td style="text-align: center;"><b>Nil</b></td> <td style="text-align: center;"><b>Rs. 25, 000</b></td> </tr> <tr> <td><b>Equity earnings E</b></td> <td style="text-align: center;"><b>Rs. 1, 00, 000</b></td> <td style="text-align: center;"><b>Rs. 75, 000</b></td> </tr> <tr> <td><b>Cost of equity Ke</b></td> <td style="text-align: center;"><b>15%</b></td> <td style="text-align: center;"><b>15%</b></td> </tr> <tr> <td><b>Cost of debentures Kd</b></td> <td style="text-align: center;"><b>10%</b></td> <td style="text-align: center;"><b>10%</b></td> </tr> <tr> <td><b>Market value of equity S = E/Ke</b></td> <td style="text-align: center;"><b>Rs. 6, 66, 667</b></td> <td style="text-align: center;"><b>Rs. 5,00, 000</b></td> </tr> <tr> <td><b>Market value of debt B</b></td> <td style="text-align: center;"><b>Nil</b></td> <td style="text-align: center;"><b>Rs. 2, 50, 000</b></td> </tr> <tr> <td><b>Total value of firm V</b></td> <td style="text-align: center;"><b>Rs. 6, 66, 667</b></td> <td style="text-align: center;"><b>Rs. 7, 50, 000</b></td> </tr> </tbody> </table> |  | <b>Firm A</b>      | <b>Firm B</b> | <b>Net operating income EBIT</b>             | <b>Rs. 1, 00, 000</b> | <b>Rs. 1, 00, 000</b> | <b>Interest on debentures I</b> | <b>Nil</b>   | <b>Rs. 25, 000</b> | <b>Equity earnings E</b> | <b>Rs. 1, 00, 000</b> | <b>Rs. 75, 000</b> | <b>Cost of equity Ke</b> | <b>15%</b> | <b>15%</b> | <b>Cost of debentures Kd</b> | <b>10%</b> | <b>10%</b> | <b>Market value of equity S = E/Ke</b> | <b>Rs. 6, 66, 667</b> | <b>Rs. 5,00, 000</b> | <b>Market value of debt B</b> | <b>Nil</b> | <b>Rs. 2, 50, 000</b> | <b>Total value of firm V</b> | <b>Rs. 6, 66, 667</b> | <b>Rs. 7, 50, 000</b> |
|--|---|--|--------------------|---------------|--|-----------------------|-----------------------|---------------------------------|--------------|--------------------|--------------------------|-----------------------|--------------------|--------------------------|------------|------------|------------------------------|------------|------------|--|-----------------------|----------------------|-------------------------------|------------|-----------------------|------------------------------|-----------------------|-----------------------|
|  | <b>Firm A</b>   | <b>Firm B</b>  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Net operating income EBIT</b>                       | <b>Rs. 1, 00, 000</b>   | <b>Rs. 1, 00, 000</b>                                  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Interest on debentures I</b>                        | <b>Nil</b>  | <b>Rs. 25, 000</b>                                     |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Equity earnings E</b>                               | <b>Rs. 1, 00, 000</b>   | <b>Rs. 75, 000</b>                                     |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Cost of equity Ke</b>                               | <b>15%</b>  | <b>15%</b>   |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Cost of debentures Kd</b>                           | <b>10%</b>  | <b>10%</b>   |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Market value of equity S = E/Ke</b>                 | <b>Rs. 6, 66, 667</b>   | <b>Rs. 5,00, 000</b>                                   |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Market value of debt B</b>                          | <b>Nil</b>  | <b>Rs. 2, 50, 000</b>                                  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Total value of firm V</b>                           | <b>Rs. 6, 66, 667</b>   | <b>Rs. 7, 50, 000</b>                                  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
|  | <table border="1" style="width: 100%;"> <tr> <td style="width: 70%;">Explanation of factors affecting capital structure</td> <td style="width: 10%; text-align: center;">6</td> <td style="width: 20%; text-align: center;">10</td> </tr> <tr> <td>Solution for the problem</td> <td style="text-align: center;">3</td> <td></td> </tr> <tr> <td>Interpretation</td> <td style="text-align: center;">1</td> <td></td> </tr> </table>  | Explanation of factors affecting capital structure     | 6                  | 10            | Solution for the problem                     | 3                     |                       | Interpretation                  | 1            |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| Explanation of factors affecting capital structure     | 6   | 10   |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| Solution for the problem                               | 3   |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| Interpretation   | 1   |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| 5  | <p><b>Explain all the sources of risk in capital budgeting with examples.</b></p> <p><b>Solve the below given problem:</b></p> <p><b>An investment will have an initial outlay of Rs 100,000. It is expected to generate cash inflows. Cash inflow for four years.</b></p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th><b>Year</b></th> <th><b>Cash inflow</b></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;"><b>1</b></td> <td style="text-align: center;"><b>40000</b></td> </tr> <tr> <td style="text-align: center;"><b>2</b></td> <td style="text-align: center;"><b>50000</b></td> </tr> <tr> <td style="text-align: center;"><b>3</b></td> <td style="text-align: center;"><b>15000</b></td> </tr> <tr> <td style="text-align: center;"><b>4</b></td> <td style="text-align: center;"><b>30000</b></td> </tr> </tbody> </table> <p><b>If the risk free rate and the risk premium is 10%,</b></p> <p><b>a) Compute the NPV using the risk free rate</b></p> <p><b>b) Compute NPV using risk-adjusted discount rate</b></p>   | <b>Year</b>  | <b>Cash inflow</b> | <b>1</b>      | <b>40000</b>                                 | <b>2</b>              | <b>50000</b>          | <b>3</b>                        | <b>15000</b> | <b>4</b>           | <b>30000</b>             |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>Year</b>  | <b>Cash inflow</b>  |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>1</b>   | <b>40000</b>  |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>2</b>   | <b>50000</b>  |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>3</b>   | <b>15000</b>  |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| <b>4</b>   | <b>30000</b>  |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
|  | <table border="1" style="width: 100%;"> <tr> <td style="width: 70%;">Explanation of risk in capital budgeting with examples</td> <td style="width: 10%; text-align: center;">5</td> <td style="width: 20%; text-align: center;">10</td> </tr> <tr> <td>Solution for the problem with interpretation</td> <td style="text-align: center;">5</td> <td></td> </tr> </table>  | Explanation of risk in capital budgeting with examples | 5                  | 10            | Solution for the problem with interpretation | 5                     |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
| Explanation of risk in capital budgeting with examples | 5   | 10   |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |
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| 6  | <p><b>Explain the objectives of Cash Management. Write about the Baumol model with their assumptions.</b></p>   |  |                    |               |  |                       |                       |                                 |              |                    |                          |                       |                    |                          |            |            |                              |            |            |  |                       |                      |                               |            |                       |                              |                       |                       |

|  |  |   |    |
|--|--|---|----|
|  | Explanation of objectives of cash management | 5 | 10 |
|  | Explanation of Baumol model with assumptions | 5 |    |