2007

COMMERCE

(Financial Management and Financial Services)

PAPER—III

Full Marks : 100

Time : 4 hours

The figures in the right-hand margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

Illustrate the answers wherever necessary.

First Half

(Financial Management)

[Marks : 50]

Answer Q. No. *1* and any *two* from the rest.

1. Answer any *four* of the following : 5×4
   (a) What are the limitations of the "Profit maximization" version of the objectives of financial management ?
   (b) Write a short note on "Organization of finance function".
   (c) Distinguish between 'business risk' and 'financial risk'.
   (d) Describe the various forms of short-term bank finance.

(Turn Over)

(e) Tewari Ltd.'s Balance Sheet as on 31.03.2007 reflects the following position :

	Rs. '000
Inventories :	
Raw materials	1,125.00
Semi-finished goods	112.50
Finished goods	225.00
Debtors	225.00
Other current assets	112.50
	1,800.00
Short-term bank borrowings	900.00
Other current liabilities	900.00
	1,800.00

Ascertain the maximum permissible bank credit under the three methods to bank lending as per the recommendations of the Tandon Comittee.

(f) State the assumptions which underlie Walter's dividend model.

(g) Show that $DFL = \dfrac{EBIT}{EBT - \frac{D_p}{(1-t)}}$

where DFL = degree of financial leverage,

EBIT = earnings before interest and tax,

EBT = earnings before tax,

D_p = preference dividend and

t = corporate tax rate.

(h) State the main propositions of the M-M capital structure theory.

2. (a) Prove : $DOL = \frac{\text{Contribution}}{\text{EBIT}}$

(b) Establish mathematically the relationship between Margin of Safety (M/S) and Operating Leverage.

(c) Discuss how various combinations of operating and financial leverage affect the total risk complexion of a firm.

(d) If, for any company, interest cost is Rs. 50,000, tax is Rs. 70,000, tax rate is 50%, preference share dividend is Rs. 30,000, number of equity shares is 20,000, calculate DFL.

(e) If, for any company, total assets turnover ratio is 1.5, p/v ratio is 60%, GP ratio is 20%, closing total assets is double of opening total assets, calculate DOL. Assume, fixed cost is 40% of total closing assets.

3+3+3+3+3

3. (a) Discuss various forms of dividend to the equity shareholders.

(b) Deduce James E. Walter (1963)'s model of relevance of dividend in market price of an equity share. State the assumptions.

(c) A company has a total investment of Rs. 5,00,000 in assets. It has 50,000 outstanding equity shares of Rs. 10 each (par value). It earns a rate of 15% on its investment and has a retention rate of 50%. If cost of capital is 10%, determine the market price of its share using Gordon's model. Ignore tax. 4+8+3

4. (a) Distinguish between 'explicit cost of capital' and 'implicit cost of capital'.

(b) Rahul Ltd. issued 10% redeemable debentures of Rs. 1000 each at a discount of 20% one year back. If the debentures are redeemed after 5 years from the date of issue at a premium of 20% and if the interest on debentures is paid annually at the end of each year, determine cost of capital at present. Assume corporate tax rate as 40% and floatation cost as 2% of face value. Use Annuity and Present Value Tables.

5+10

5. (a) The following information is available for Krish Ltd. :

	Rs. '000
Average stock of raw materials	400
Average work-in-progress inventory	500
Average finished goods inventory	350
Average accounts receivable	400
Average accounts payable	250
Average raw materials consumed per day	20
Average work-in-progress value of raw materials committed per day	25
Average cost of goods sold per day	35
Average sales per day	40

Ascertain the duration of the operating cycle.

(b) Describe any four factors affecting working capital requirement in a company.

(c) Discuss the main features of 'hedging approach' to working capital financing. 5+5+5

Second Half

(Financial Services)

[Marks : 50]

Answer Q. No. *6* and any *two* from the rest

6. Answer any *four* of the following : 5×4

(a) Discuss the benefits of credit rating from the viewpoints of an investor and a company respectively.

(b) What are the important services rendered in general by a merchant banker.

(c) Distinguish between 'fund-based' and 'fee-based' financial services with examples.

(d) Describe the role of financial institutions in the financial system.

(e) Write short notes on : 'Leveraged lease' and 'Sale and lease back'.

(f) What are the factors affecting assignment of credit rating to securities?

(g) Explain the mechanism of factoring services.

(h) Discuss the major sources of funds for the HFCs in India.

7. (a) Explain the role of financial system in developing a country's economy.

(b) Describe the methodology adopted by CRISIL in credit rating of securities. 7+8

8. (a) Y Co. Ltd. has entered into a lease agreement for an equipment costing Rs. 800 lakh. The lease is non-cancellable for a period of five years. The annual lease rentals payable amount to Rs. 300 Rs./1,000 on due basis. Economic life of the equipment is expected to be eight years. Y Co. Ltd. uses written down value method @ 30% to depreciate the equipment. The incremental borrowing rate is 20% p.a. Y. Co. Ltd. is in a tax bracket of the marginal rate of 50%.

From the above information, in the books of the lessee, Y Co. Ltd. :

(i) Determine the capitalised value of the equipment, and

(ii) Prepare a schedule showing the allocation of unexpired finance charges over the lease term year-wise.

(b) The annual turnover of Z Co. Ltd. is Rs. 160 lakh of which 75% is on credit and its average collection period is 3 months. The past experience indicates that bad debt losses are around 2.5% of credit sales. The company spends Rs. 2,50,000 p.a. on administering its credit sales which includes salaries of one officer and three clerical personnel who handle credit checking, collection etc.

Y Co. Ltd., a factor is prepared to buy the company's receivables by charging 2% commission. The factor will pay advance against receivables at an interest rate of 15% p.a. after withholding 20% as reserve.

Presently, the company suffers from liquidity problem due to blockage of working capital in debtors. To meet the shortage of working capital, the company, Z Co. Ltd. borrows Rs. 20,00,000 from a commercial bank at an interest rate of 12% p.a. If factoring service is taken, the loan is not required.

From the above information,

(i) Compute the net advance amount payable by the factor.

(ii) As a financial consultant, advise whether the company should manage its debtors through in-house management system or through factoring services. (2+5)+(3+5)

9. Sunlight Co. Ltd. is considering to use a new equipment in its production process. The equipment can be used in the factory after taking a decision under any one of the three following ways :

(i) borrowing the cost of purchasing the equipment from a bank,

(ii) taking the equipment on lease which is non-cancellable for the lease term,

(iii) taking the equipment on lease on a renewal basis from year-to-year over the lease term.

The necessary information and data concerning the three alternative decisions are given as follows :

In case of borrowing from a bank, interest rate is 18% p.a., Annual interest is payable at the year-end. Principal sum of loan is payable at the end of the borrowing term.

In case of 'non-cancellable' nature of lease, annual lease rentals payable amount to Rs. 300/Rs. 1,000 on due basis.

In case of 'year-end renewable' nature of lease, annual lease rentals payable amount to Rs. 280/Rs. 1,000 on due basis for the first year with a provision of 10% annual increase of the amount of rent.

The common information about the new equipment is given as follows : Cost of the equipment os Rs. 10,00,000;

Expected operating life of the equipment is 5 years; Lease term, in both options of lease is 5 years; Guaranteed residual value (in case of 'non-cancellable' lease only) is Rs. 1,00,000; Repair and maintenance cost (in cases of ownership and a particular type of lease as per convention) is Rs. 1,00,000 p.a.

Sunlight Co. Ltd. falls under a marginal rate of tax of 50%. As per present income tax laws, depreciation can be claimed by the lessee in case of 'non-cancellable' lease only if the lessor and lessee make a written agreement in this regard. Sunlight Co. Ltd. is to make a formal written agreement in case it goes for the same option. For calculation of depreciation on equipment, lease rent, etc. for income tax purpose, existing provisions of the accounting standard are to be applied.

The company wants to use a cost of capital rate of 10% for evaluation of the alternative options. Depreciation @ 25% on written down value is to be charged every year.

Advise the company regarding taking an appropriate decision. 15

10. (a) What are the 'early-stage' and 'later-stage' of venture capital financing?

(b) What do you mean by 'investment nurturing' or 'after-care' by the VCIs?

(c) Give three important objectives of 'after-care' by the VCIs.

(d) Mention the various styles of 'investment nurturing' or 'after-care'. 5+3+3+4